REPORT TO THE MINISTER

In the Matter of the *Trade Practice Act*,
R.S.B.C. 1979, c. 406

and

In the Matter of First Investors Corporation Ltd.,
Associated Investors of Canada Ltd.,
Principal Consultants Ltd.,
Principal Savings and Trust Company, and
Principal Group Ltd.

OCTOBER 14, 1987

Province of British Columbia

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REPORT TO THE MINISTER

IN THE MATTER OF THE TRADE PRACTICE ACT
R.S.B.C. 1979, c. 406

AND

IN THE MATTER OF FIRST INVESTORS CORPORATION LTD.,
ASSOCIATED INVESTORS OF CANADA LTD.,
PRINCIPAL CONSULTANTS LTD.,
PRINCIPAL SAVINGS AND TRUST COMPANY, AND
PRINCIPAL GROUP LTD.

OCTOBER 14, 1987

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DEFINITION OF TERMS USED IN THIS REPORT

"AIC" means Associated Investors of Canada Ltd.

"CDIC" means Canada Deposit Insurance Corporation.

"Commission" means the Commission of Inquiry appointed by the Minister's Order.

"FIC" means First Investors Corporation Ltd.

"FIC/AIC" means First Investors Corporation Ltd. and/or Associated Investors of Canada Ltd.

"Investment Contract Act" means the Investment Contract Act, R.S.B.C. 1979, c. 207, unless otherwise stated.

"Minister" means Minister of Labour and Consumer Services or the Acting Minister of Labour and Consumer Services.

"Minister's Order" means the Order of the Minister appointing this Commission of Inquiry.

"RRSP" means Registered Retirement Savings Plan

"Securities Act" means the Securities Act, S.B.C. 1985, c. 83.

EXECUTIVE SUMMARY
OF
RECOMMENDATIONS

RECOMMENDATION ONE:

If the Plans of Arrangement are approved by the Alberta Court of Queen's Bench, it should not be necessary for the British Columbia Director of Trade Practices to take any further legal proceedings with respect to the realization of the assets of FIC/AIC or the distribution of the proceeds of those assets to investors.

RECOMMENDATION TWO:

If the Province of Alberta purports to pay a share of the fees of Coopers & Lybrand in a manner that has the effect benefiting only those investors residing in Alberta, consideration should be given to making an application to the Alberta Court of Queen's Bench for an Order to ensure that all investors are treated on a pro rata basis regardless of their province of residence.

RECOMMENDATION THREE:

In the event that the Plan of Arrangement for either FIC/AIC is not approved, and either or both of FIC/AIC are put into bankruptcy, the British Columbia Director of Trade Practices should be directed to assist the holders of FIC/AIC investment contracts with the completion and filing of Proofs of Claim and proxies with any Trustee in Bankruptcy who may be appointed with respect to either or both of FIC/AIC.

RECOMMENDATION FOUR:

(A) The British Columbia Director of Trade Practices should make some form of public announcement to notify FIC/AIC investors of their right to file a claim in bankruptcy against Principal Group Ltd.

(B) The offices of the British Columbia Director of Trade Practices should serve as distribution points to provide FIC/AIC investors with Proof of Claim forms and provide information with respect to where the Proof of Claims should be sent. The Director should neither assume responsibility for advising investors upon whether they have a valid claim nor assist investors in completing or filing Proof of Claim forms. If an investor requires assistance with the completion or filing of a Proof of Claim form, the investor should be advised to seek independent legal counsel.

RECOMMENDATION FIVE:

The British Columbia Director of Trade Practices should maintain a directory of FIC/AIC investors who advise the Director that their claims in bankruptcy against Principal Group Ltd. have been disallowed by the Trustee in Bankruptcy and the Director should provide other FIC/AIC investors, whose claims have been disallowed, with access to this directory.

RECOMMENDATION SIX:

The offices of the British Columbia Director of Trade Practices should serve as distribution points to provide investors with Proof of Claim forms for claims against Principal Savings and Trust Company and to provide investors with information as to where a Proof of Claim should be sent.

RECOMMENDATION SEVEN:

The Director of Trade Practices should add Donald M. Cormie as a defendant in the legal proceedings commenced by the Director on behalf of British Columbia investors, pursuant to the Trade Practice Act, or take such alternative proceedings as the Director's legal counsel may advise.

RECOMMENDATION EIGHT:

(A) Consideration should be given to making legislative amendments which will require an investment contract company to provide a copy of its most recent audited financial statements to an investor or prospective investor upon the request of such an investor.

(B) Consideration should be given to making legislative amendments which will provide that any person may, upon payment of a reasonable charge, obtain copies of the audited financial statements of an investment contract company from the regulatory agency where such statement which are required to be filed.

(C) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A) and (B) apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

RECOMMENDATION NINE:

(A) Consideration should be given to making legislative amendments which will require an investment contract company to provide prospective investors with sufficient particulars of the company's investment portfolio to enable a prospective investor to ascertain the specific nature of the investments held by the company and the approximate proportion of the total investment portfolio that each class of investments represents.

(B) Consideration should be given to making legislative amendments which will require an investment contract company to immediately advise investors of any material change in the nature of its investment portfolio.

(C) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A) and (B) apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

RECOMMENDATION TEN:

(A) Consideration should be given to making legislative amendments which would limit use of the term "guarantee" in relation to the sale of investment contracts, investment certificates, and investment receipts to circumstances:

   (i) where the investment is insured by the Canada Deposit Insurance Corporation;

   (ii) where the investment is guaranteed or insured by the Credit Union Deposit Insurance Corporation of British Columbia;

   (iii) where the investment is guaranteed by another legal entity which operates at arms-length from the company offering the guaranteed investment, and the identity of the guarantor is clearly identified to the purchaser;

(iv) where the investment is guaranteed by another legal entity approved by the British Columbia Securities Commission or similar regulatory agency.

(B) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A)(ii) to (iv) inclusive apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

RECOMMENDATION ELEVEN:

(A) Consideration should be given to making legislative amendments which will require that any application form, which an investment contract company proposes to use, be approved by the Superintendent of Brokers or other regulatory official before it is used by an investment contract company.

(B) Consideration should be given to requiring the identity of the investment contract company which is offering the investment contract be clearly identified in bold lettering on the face of the application form.

(C) Consideration should be given to requiring that the absence of CDIC insurance coverage be displayed in bold print immediately above the space provided for the signature of the applicant.

(D) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A) to (C) inclusive apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

RECOMMENDATION TWELVE:

Consideration should be given to repealing the Investment Contract Act and making such amendments to the Securities Act as may be necessary to bring investment contract companies under the jurisdiction of those parts of the Securities Act that would be applicable to investment contract companies. If this recommendation is accepted, it may be necessary to consider enacting some transition provisions which will apply to the one remaining company which is currently registered under the Investment Contract Act and thereby enable that company sufficient time to comply with the provisions of the Securities Act.

RECOMMENDATION THIRTEEN:

(A) Consideration should be given to entering into discussions with the Canada Deposit Insurance Corporation with the object of limiting the use, by a member institution, of references to "Canada Deposit Insurance Corporation" to only those deposits, term deposits, term certificates, investment receipts and other investments which are covered by CDIC insurance, rather than permitting the use of a general reference to CDIC membership by a financial institution which also sells investments which are not covered by CDIC insurance.

(B) If the objective described in the preceding paragraph cannot be achieved, then, as an alternative, consideration should be given to requiring financial institutions which operate in British Columbia and which sell some investments which are covered and some which are not covered by CDIC insurance, to state, in any advertising published in British Columbia that includes a reference to CDIC, that not all of the investments sold by the financial institution are covered by CDIC insurance.

RECOMMENDATION FOURTEEN:

Consideration be given to a proposal which would require a proportion of the investments of an investment contract company that is approximately equal to the proportion of investment contracts sold in British Columbia, to be invested in either property which is located in British Columbia, or securities which are held by a custodian which is present in British Columbia and approved by the appropriate regulatory agency.

RECOMMENDATION FIFTEEN:

Subject to the stipulations enumerated in Recommendations 16 to 21 inclusive, the evidence gathered by the Commission during the course of the Inquiry should be delivered into the custody of the Director of Trade Practices appointed pursuant to the Trade Practice Act.

RECOMMENDATION SIXTEEN

The Director of Trade Practices and his legal counsel may use the evidence in the continuation of the legal proceedings which the Director has already commenced or for such other proceedings as the Director may commence.

RECOMMENDATION SEVENTEEN:

The Attorney-General of British Columbia, or agents authorized by him, should have access to the evidence and should have the right to make such copies of the evidence as he may require.

RECOMMENDATION EIGHTEEN:

The Special Counsel, who is referred to in Part 15.1 of this Report, and who has been appointed by the Alberta Court of Queen's Bench to represent British Columbia investors, should have access to the evidence and he should have the opportunity to make such copies of the evidence as he may require.

RECOMMENDATION NINETEEN:

The Inspector, who is referred to in Part 15.6 of this Report and who has been appointed pursuant to the Order of the Alberta Court of Queen's Bench to inquire into the Principal Group of Companies, should have access to the evidence and he should have the opportunity to make such copies of the evidence as he may require.

RECOMMENDATION TWENTY:

Persons, who may be authorized by the Minister of Labour and Consumer Services, or the Director of Trade Practices, should have access to the evidence and should have the opportunity to make such copies of the evidence as they may require. In this regard, I recommend that authorization, pursuant to this paragraph, be granted to a member of any class of investors referred to in this Report or legal counsel who has been retained by the investor.

RECOMMENDATION TWENTY-ONE:

There are three categories of evidence which were obtained as part of the Commission of Inquiry which should not be made accessible as recommended above.

(A) Evidence that pertains to the confidential circumstances of certain investors.

This evidence was provided to the Commission of Inquiry in confidence, and will not assist in the advancement of claims of other investors. There is no public interest to be served by making this evidence accessible to others. This evidence will be delivered under separate cover to the Minister.

(B) A Single Binder of Financial information pertaining to FIC/AIC obtained on a confidential basis.

I anticipate that the documents in this binder will be tendered in evidence before the Alberta Inquiry being conducted by Mr. William Code, Q.C. This evidence will be delivered under separate cover to the Minister.

(C) One item of evidence which is still the subject of Investigation.

There is one item of evidence which is still under investigation. This evidence should be made accessible, as recommended above, as soon as the investigation of the evidence has been completed. This evidence will be delivered to the Director of Trade Practices for use in any proceedings commenced by him, and a copy of the evidence should be made immediately available to the the Special Counsel referred to in Part 15 of this Report.

REPORT TO THE MINISTER

This Report is submitted to the Acting Minister of Labour and Consumer Services pursuant to the terms of the Minister's Order which is reproduced in Appendix 1 of this Report. The Report is contained in two volumes. Volume I contains the text of the Report and Volume II contains the Appendices referred to in Volume I. A copy of Volume II may be obtained upon request from:

Director of Trade Practices
Ministry of Labour and Consumer Services
1019 Wharf Street
Victoria, British Columbia
V8V 1X4

1. APPOINTMENT AND TERMS OF REFERENCE

The terms of reference provide that an inquiry be undertaken to determine whether First Investors Corporation Ltd., Associated Investors of Canada Ltd., Principal Savings and Trust Company, Principal Consultants Ltd., and Principal Group Ltd., or any of them engaged in misleading or deceptive acts or practices in respect of consumer transactions pertaining to investments offered by these companies. The terms of reference proceed to specify several types of representations which may have been misleading or deceptive.

2. PUBLICATION OF NOTICE OF INQUIRY

A Notice of the Inquiry was published in all daily newspapers published in British Columbia. A copy of the Notice was served on the registered attorney for service in British Columbia of each of the companies named in the Minister's Order. A copy of the advertisement is reproduced in Appendix 2 of this Report. The advertisement announced the location, date and time of the Public Hearings and the address to which written submissions could be sent.

3. PUBLIC HEARINGS

Nine Public Hearings were held at the places and dates set forth below:

Victoria	(two hearings)	July 28, 1987
Kelowna	(two hearings)	July 30, 1987
Vancouver	(two hearings)	August 5, 1987
Vancouver	(two hearings)	August 6, 1987
Kamloops		August 20, 1987.

A list of the names of the persons who made submissions at these Public Hearings is included in Appendix 3 of this Report.

4. ATTENDANCE AT MEETINGS OF INVESTOR GROUPS

In addition to the formal Public Hearings, I attended meetings of regional groups of investors, upon the invitation of the investors, at the places and dates set forth below:

Victoria	August 31, 1987
Richmond	September 2, 1987
Kelowna	September 11, 1987
Victoria	September 16, 1987.

5. QUESTIONNAIRE

A questionnaire for investors was prepared and copies were distributed at all of the Public Hearings and delivered or sent to all investors who requested a questionnaire. A copy of the questionnaire is reproduced in Appendix 5 of this Report. Approximately 2,000 questionnaires have been submitted by or on behalf of investors. The information from these questionnaires has been entered into computer files and analysed.

6. WRITTEN SUBMISSIONS

Many of the investors who returned questionnaires also made a written submission and enclosed copies of their documentation. In addition, several hundred investors who did not return a questionnaire made a written submission which included copies of their documentation.

7. INTERVIEWS OF WITNESSES

Approximately 100 people have been interviewed in person or by telephone during the course of the Commission of Inquiry.

8. DOCUMENTARY EVIDENCE AND TESTIMONY

Several persons have been examined under oath with respect to their knowledge of the matters pertaining to the Inquiry.

There may be others in British Columbia whose evidence would be useful in any future legal proceedings that may be taken by or on behalf of investors. Most of the people in this category are management or sales personnel who were associated with the named companies.

Most of the corporate officers of companies named in the Minister's Order and many of the people who held senior management positions with the named companies do not reside in British Columbia but reside in the Province of Alberta.

A substantial number of documents pertaining to the operations of the companies named in the Minister's Order have been obtained. An inventory of these documents is included in Appendix 8 of this Report.

All of the named companies are Alberta companies. Consequently, all of their corporate records and most of their business records are located in Alberta. In addition, documents and correspondence which the named companies filed or sent to various regulatory agencies in the Province of Alberta are located in Alberta.

A Commission of Inquiry appointed pursuant to legislation in the Province of British Columbia does not have the power to summons witnesses or subpoena documents located in another province or jurisdiction. Some consideration has been given to whether the British Columbia Subpoena (Interprovincial) Act, R.S.B.C. 1979, c.396, and the Alberta Interprovincial Subpoena Act, S.A., 1981, c. I-8.1, could be used by a Commission of Inquiry in British Columbia for the purpose of summoning and compelling the attendance of witnesses who are resident or present in Alberta. Several hurdles would have to be overcome before these statutes could be used for this purpose. One of the more significant hurdles would involve requesting the Lieutenant-Governor in Council of the Province of Alberta to designate the British Columbia Commission of Inquiry as a "Court". Any further consideration of whether it is desirable or necessary to use these statutes for the purpose of getting access to witnesses and evidence in the Province of Alberta should be postponed until the hearings of the Alberta Inquiry being conducted by Mr. William Code, Q.C. have been completed. The scope and nature of the Alberta Inquiry are discussed in greater detail in Part 15.2 of this Report. I anticipate that all of the corporate and business records of the named companies and the relevant records of the Government of Alberta will be produced and made part of the public record of the Alberta Inquiry. Furthermore, I anticipate that most if not all of the Alberta witnesses, who have come to my attention, will be called as witnesses before the Alberta Inquiry and will be subject to cross-examination by the Special Counsel who has been appointed to represent British Columbia investors. If there are witnesses who, for whatever reason, are not examined under oath as part of an Alberta Inquiry, and who should be examined under oath, further consideration can be given to using the above mentioned interprovincial subpoena statutes to compel their testimony in British Columbia.

9.0: OVERVIEW

Many of the people whose funds are at risk, as a consequence of the failure of First Investors Corporation Ltd., Associated Investors of Canada Ltd., and Principal Group Ltd., are persons who have reached or are approaching normal retirement age. Thirty-four percent of the investors who returned questionnaires to the Commission were over the age of 65 years and this percentage increases to 51% if persons over 60 years of age are included in the analysis. Their funds, which are at risk, are for the most part funds which they had saved for their retirement years. Many of these people had little if any experience with respect to investing money. Indeed, they did not regard themselves as investors but rather as "savers". When they went to "Principal" they were looking for a financial institution where their retirement savings would be kept safely and bear interest at a competitive rate. Some of them transferred their funds to "Principal" from a chartered bank or other financial institution where the funds were covered by CDIC insurance. There were often several reasons why they transferred their funds to Principal. In some cases, there is no doubt they were involved in "interest rate shopping", but this was usually done on the assumption that they were comparing interest rates among financial institutions which offered the same form of security. In some cases the interest rate offered by "Principal" was either the same as the rate being offered by some of the chartered banks, or the rate offered by "Principal" was only one-quarter to one-half of one percent higher than the rate offered by a chartered bank. The assumption that "Principal" offered the same financial security as other financial institutions was often the product of representations which were made by the Principal consultants or sales personnel. The nature and effect of these representations is described in Part 12 of this Report. Most of these people did not think they were speculating with their savings by investing in high risk investments or second mortgages with interest rates substantially higher than rates on bank term deposits.

I have deliberately refrained from using the term "investor" in this "overview" because many of the people who have been issued "investment contracts" did not regard themselves as investors. They believed they had placed their funds in a "term deposit certificate" with Principal Savings and Trust Company. However, in the balance of the Report, I have frequently referred to them as "investors" because that is how they have been referred to in various legal proceedings which have taken place.

10.0: CORPORATE STRUCTURE, ROLE AND STATUS OF THE COMPANIES NAMED IN THE MINISTER'S ORDER

Prior to discussing the nature and effect of the representations upon which many of the investors acted, it is important to have a clear understanding of the corporate structure and relationship of the companies named in the Minister's Order.

The five companies named in the Minister's Order are all members of a group that was referred to as the "Principal Group of Companies". The corporate structure, role, and legal status of each company is described below.

10.1: Principal Group Ltd.

Principal Group Ltd. is a company incorporated under the laws of the Province of Alberta and registered in British Columbia as an extra-provincial company pursuant to Part 10 of the Company Act, R.S.B.C. 1979, c.59. This company is the parent company of the four other companies named in the Minister's Order. The directors of this company, who are named in records filed with the British Columbia Registrar of Companies, are Donald M. Cormie (President), James M. Cormie, John M. Cormie, Bruce G. Cormie, Kenneth M. Marlin, Reginald Bacchiohi, S. William Nicholson, Lynn A. Patrick, John Ritchie, and Christa V. Petracca. The company is a wholly owned subsiduary of Collective Securities Inc., which is also an Alberta company incorporated under the laws of Alberta. The shares of the latter company are held either by members of the Cormie family or by personal holding companies of Donald M. Cormie and Kenneth N. Marlin.

Principal Group Ltd. issued or sold promissory notes to investors in British Columbia pursuant to an exemption under section 32 of the Securities Act, S.B.C., 1985, c. 83. These notes are sometimes referred to as "corporate notes". This exemption was suspended by an order of the British Columbia Securities Commission dated July 31, 1987. Most of these notes are in denominations in excess of $97,000; however, some which were issued several years ago were for lesser amounts.

On August 10, 1987, Principal Group Ltd. made a voluntary assignment in bankruptcy pursuant to the Bankruptcy Act, R.S.C. 1970, c. B-3. Mr. J. Stephens Allan, of the firm of Collins Barrow Limited, was appointed as the Trustee in Bankruptcy by the Official Receiver in Bankruptcy in Edmonton, Alberta.

10.2: First Investors Corporation Ltd.

First Investors Corporation Ltd. is a company incorporated under the laws of the Province of Alberta and registered in British Columbia as an extra-provincial company pursuant to Part 10 of the Company Act, R.S.B.C. 1979, c.59. This company is a wholly owned subsidiary of Principal Group Ltd. The directors of this company, who are named in records filed with the British Columbia Registrar of Companies, are Kenneth N. Marlin, (President), Lance Frazier (Vice-President), Christa V. Petracca (Secretary).

This company was also registered in British Columbia under the Investment Contract Act, R.S.B.C. 1979, c. 207. Registration under this Act permitted the company to sell investment contracts in British Columbia. An analysis of this Act, and the registration of this company under the Act, is contained in Part 14 of this Report.

On June 30, 1987, First Investors Corporation Ltd. made an application to the Alberta Court of Queen's Bench pursuant to the Companies Creditors' Arrangement Act, R.S.C., 1970, chap. C-25. Upon hearing that application, the Court made a declaration that the Act applied to the company, and the Court appointed Coopers & Lybrand to manage the assets and liabilities of the company. This order had the effect, pursuant to section 16 of the said Act, of staying or prohibiting other legal proceedings in relation to the company in Alberta and in all of the provinces of Canada, unless the Alberta Court of Queen's Bench granted permission to commence or continue legal proceedings.

On June 30, 1987, the registration of this company to sell investment contracts in Alberta was cancelled by the appropriate regulatory agency in Alberta. On the next business day, July 2, 1987, the registration of this company to sell investment contracts in British Columbia was cancelled by the Superintendent of Brokers.

10.3: Associated Investors of Canada Ltd.

Associated Investors of Canada Ltd. is a company incorporated under the laws of the Province of Alberta and registered in British Columbia as an extra-provincial company pursuant to Part 10 of the Company Act, R.S.B.C. 1979, c.59. This company is a wholly owned subsidiary of Principal Group Ltd. The directors of this company, who are named in records filed with the British Columbia Registrar of Companies, are Kenneth N. Marlin (President), Christa V. Petracca (Secretary), and Eric J. Espenberg (Treasurer).

This company was also registered under the Investment Contract Act, R.S.B.C. 1979, c.207., which permitted the company to sell investment contracts in British Columbia. An analysis of this Act, and the registration of this company under the Act, is contained in Part 14 of this Report.

On June 30, 1987, Associated Investors of Canada Ltd. made an application to the Alberta Court of Queen's Bench pursuant to the Companies Creditors' Arrangement Act, R.S.C., 1970, chap. C-25. Upon hearing that application, the Court made a declaration that the Act applied to the company, and the Court appointed Coopers & Lybrand to manage the assets and liabilities of the company. This order had the effect, pursuant to section 16 of the said Act, of staying or prohibiting other legal proceedings in relation to the company in Alberta and in all of the provinces of Canada, unless the Alberta Court of Queen's Bench granted permission to commence or continue legal proceedings.

On June 30, 1987, the registration of this company to sell investment contracts in Alberta was cancelled by the appropriate regulatory agency in Alberta. On the next business day, July 2, 1987, the registration of this company to sell investment contracts in British Columbia was cancelled by the Superintendent of Brokers.

10.4: Principal Savings and Trust Company

Principal Savings and Trust Company is a company incorporated under the laws of the Province of Alberta and registered in British Columbia as an extra-provincial company pursuant to Part 10 of the Company Act, R.S.B.C. 1979, c.59. It was also registered in British Columbia pursuant to the Trust Company Act, R.S.B.C. 1979, c.412. This company is a wholly owned subsiduary of Principal Group Ltd. The directors of this company named in the most recent documents filed by the company with the British Columbia Superintendent of Trust Companies are Donald M. Cormie (Chairman of the Board), John Cormie (President), Christa V. Petracca, Adeline N. Smith, Robert G. Pearce, George Aboussafy, Allison B. Cormie, and Kenneth N. Marlin. Immediately prior to the cessation of business in British Columbia, the company maintained branches at several locations in British Columbia including Vancouver, Victoria, Coquitlam and Kelowna.

When the parent company of Principal Savings and Trust made an assignment in bankruptcy, actions were immediately taken in both British Columbia and Alberta which had the effect of closing the operation of the trust company and preserving its deposits and assets. Canada Deposit Insurance Corporation applied to the Alberta Court of

Queen's Bench for an Order that Principal Savings and Trust Company be wound up, pursuant to the Winding-Up Act, R.S.C. 1970, c.W-10. On August 17, 1987, the Court granted the Order and appointed Bruce I. Robertson and Associates Ltd. as the Provisional Liquidator of Principal Savings and Trust Company.

10.5: Principal Consultants Ltd.

Principal Consultants Ltd. is a company incorporated under the laws of the Province of Alberta and registered in British Columbia as an extra-provincial company pursuant to Part 10 of the Company Act, R.S.B.C. 1979, c.59. This company is a wholly owned subsiduary of Principal Group Ltd. The directors of this company, who are named in records filed with the British Columbia Registrar of Companies, are Kenneth N. Marlin (President), Donald Grant Mitchell, Hugh James Moulton, and James G. Gilhooly.

This company served as the marketing agent for investment contracts issued by First Investors Corporation Ltd. and Associated Investors of Canada Ltd., promissory notes issued by Principal Group Ltd., term deposit certificates issued by Principal Savings and Trust Company, and mutual funds offered by several other members of the Principal Group of companies. Its sales personnel were registered pursuant to section 6 of the Investment Contract Act, R.S.B.C. 1979, c.207. Most, if not all, of the sales personnel were also registered to sell mutual funds pursuant to the Securities Act S.B.C. 1985, c.83 and the legislation which preceded this statute. The sales personnel were referred to as "Principal consultants" by the company, themselves, and by their customers.

11.0: METHODS OF OPERATION OF THE NAMED COMPANIES

11.1: Physical Relationship of Offices

In those locations in British Columbia where Principal Savings and Trust Company maintained a branch office, a close physical relationship existed between the operations of Principal Consultants Ltd. and Principal Savings and Trust Company. The space occupied by Principal Consultants Ltd. was located either within the same premises as Principal Savings and Trust Company, or from premises which were adjacent to, and connected with, the offices of Principal Savings and Trust Company. In these locations, the names of various Principal Group companies were listed on the door or windows of these premises. For example, Eileen Wershler, Consumer Law Investigator for the Ministry of Labour and Consumer Services, reported that on July 8, 1987, she attended the Vancouver office of Principal Savings and Trust Company, located at 110 - 626 Howe Street, and observed the following lettering displayed on the glass entrance doors:

> Principal Group of Companies
>
> Principal Savings and Trust Company
> Collective Mutual Fund
> Principal Growth Fund
> Principal Venture Fund Limited
> Principal Bond Fund
> First Investors Corporation Ltd.
> Associated Investors of Canada Limited
>
> Agents: Principal Consultants Ltd.

Eileen Wershler also reported that she observed a decal on a window that was adjacent to the door. This decal, which was located approximately ten feet from the door, contained words to the following effect: "Member, Canada Deposit Insurance Corporation. This decal did not limit its application to any one or more of the companies whose names were listed on the door. Other locations in British Columbia also displayed a sign or decal indicating membership in the Canada Deposit Insurance Corporation. These signs or decals did not specify which companies were members, or limit the representation of membership to Principal Savings and Trust Company. Photographs of the Victoria location of Principal Savings and Trust, one of which depicts the CDIC decal, are included in Appendix 11.1 of this Report.

Principal Consultants Ltd. also carried on its business from locations where there wasn't a Principal Savings and Trust Company branch office. This type of office was maintained at various times in Penticton, Kamloops, Prince George, Vernon, Richmond, Nanaimo, Courtney, and New Westminister. These offices often bore the name of "Principal Financial Centre". At some of these offices, the names of several of the Principal Group of Companies were listed on the door or windows. Some of these offices also acted as a "satellite office" of Principal Savings and Trust Company. These satellite offices accepted deposits for Principal Savings and Trust Company and forwarded them by mail or courier to the office of Principal Savings and Trust where the customer maintained his or her account. Appendix 11.1 of this report includes two photographs of the office located in Penticton, British Columbia. The photograph marked with the letter "A" depicts the front of the office with a sign hanging in the window bearing the words "Principal Financial Centre". The photograph marked with the letter "B" depicts a closer view of the front door of the Penticton office which bears a sign referring to the "Principal Group of Companies".

11.2: Newspaper Advertising

Virtually all of the newspaper advertisements which have been submitted to the Commission pertaining to investments offered by the Principal Group of companies were published by Principal Savings and Trust Company. These advertisements prominently displayed the interest rate offered by Principal Savings and Trust Company. These advertisements usually contained the words "Member of Canada Deposit Insurance Corporation" or words to that effect. Copies of typical advertisements are included in Appendix 11.2 of this Report. Many investors who made submissions to the Commission stated that they visited one of the "Principal" offices after reading one of these advertisements.

11.3: Range of Investments Offered for Sale:

The sales personnel of Principal Consultants Ltd. were limited to selling investments which were offered by one of the Principal Group of companies. The range of investments may, for this purpose, be roughly divided into five categories:

(a) Mutual funds offered and managed by Principal Securities Management Ltd.;

(b) Investment Contracts offered by FIC/AIC;

(c) Term Deposit Certificates offered by Principal Savings and Trust Company;

(d) Registered Retirement Savings Plans offered by each of Principal Savings and Trust Company, FIC and AIC; and

(e) Promissory Notes offered by Principal Group Ltd.

11.4: Qualifications and Training of Sales Personnel:

The sales personnel of Principal Consultants Ltd. were usually referred to by staff of the Principal Group of companies and investors as "Principal consultants". Some of the promotional literature published by Principal represented these sales personnel to be "financial consultants" or "professional consultants". A brochure entitled "The Principal Story" contains an example of this type of representation. A copy of this brochure is included in Appendix 11.4 of this Report. Many investors reported that they regarded the sales personnel as being their personal financial consultant. There was a conflict in the information received by the Commission with respect to the qualifications and training of the sales personnel. Some training programs for sales personnel were conducted by Principal Consultants Ltd. Colin Rich, a former Area Vice-President of Principal Consultants Ltd., described the training program as better than that provided by Principal's competitors. On the other hand, some former Principal consultants have told the Commission that they received very little formal training from Principal Consultants Ltd. Those Principal consultants who did have previous experience with another financial institution may not have had the expertise to provide service to their customers as a "financial consultant".

11.5: Payment of Sales Personnel

The sales personnel of Principal Consultants Ltd. were paid by way of commissions earned on sales. The rate of the commission varied depending on the type of investment which they sold. The rates of commission changed from time to time; however, the rate differential among various types of investments remained relatively constant. A copy of one of the typical commission schedules is included in Appendix 11.5 of this Report. The highest commission was usually paid to the Principal consultant if the customer invested in one of the Principal mutual funds. If the customer's money was placed in a Principal Savings and Trust Company term deposit certificate, which was insured by the Canada Deposit Insurance Corporation, the Principal consultant received a commission of $1.50 per thousand dollars of investment. If the customer's money was placed in an investment contract with First Investors Corporation Ltd. or Associated Investors of Canada Ltd., the Principal consultant received a commission of $3.00 per thousand dollars of investment.

The fact that the Principal consultants were paid higher commissions on non-insured investments has been the subject of considerable adverse criticism by investors. There is no doubt the commission schedule of Principal Consultants Ltd. provided an incentive to sell mutual funds, or failing that, to sell either a FIC or AIC investment contracts rather than placing the customer's funds in a term deposit certificate with Principal Savings and Trust Company. However, I have been unable to discern any illegality in this practice. The Principal consultants were agents of the vendors who were selling products in the same manner as the sales personnel of an automobile dealership. The Principal consultants were not the agents of the purchaser notwithstanding they tried to earn the confidence and trust of their customers. There is no obligation upon either of these types of salespersons to disclose their commissions to their customers. Furthermore, I am not prepared to recommend controls be placed on the practice of paying different commissions. I do not view the circumstances here as being an example of an agent earning a secret commission which is not disclosed to the person who hired the agent. Even if it were thought to be desirable to regulate commissions earned by sales personnel, it would be virtually impossible to enforce such regulations.

11.6: Referrals from Principal Savings and Trust to Principal Consultants

When a person came into a Principal Savings and Trust Company office to purchase a Principal Savings and Trust term deposit certificate, the company practice was to refer the person to one of the sales personnel of Principal Consultants. In most of these instances, the investor did not realize that he or she was no longer dealing with an employee of Principal Savings and Trust Company. The sales personnel of Principal Consultants Ltd. were often located in the same premises as Principal Savings and Trust Company and there was usually no physical demarcation between the two operations to let the customer know that he or she had passed from the sphere of Principal Savings and Trust Company to Principal Consultants Ltd.

11.7: Telephone Solicitations and Referrals

Although a portion of the investments sold by Principal Consultants were made as a consequence of the referrals from Principal Savings and Trust Company described above, several former Principal consultants have told the Commission that more of their contacts with potential investors came about as result of telephone solicitations or referrals from other persons. The company itself placed considerable emphasis on this method of solicitation. Suggested forms of introductions, which could be used by Principal consultants, were provided to them as a "sales aid". A copy of this sales aid is included in Appendix 11.7 of this Report. It may be observed that some of the introductions in the "sales aid" suggest that the Principal consultant introduce himself or herself by saying "I'm with Principal Savings and Trust". It would be clear misrepresentation for a Principal consultant to introduce himself or herself in this manner.

11.8: Sales Presentations to Prospective Investors

The sales presentations which Principal consultants made to potential investors either in person or by telephone often contained representations. The validity of these representations is discussed in Part 12 of this Report.

11.9: Promotional Literature:

Various forms of promotional literature were provided to prospective investors. This literature included brochures and pamphlets on the full range of investments offered by the various members of the Principal Group of companies. This literature contained various representations about the characteristics of the investments which are considered in greater detail in Part 12.7 of this Report.

11.10: Telephone Roll-overs

When an investment in any one of the Principal group of companies was about to mature, both the investor and the local office of Principal Consultants Ltd. received notification of the impending maturity. It was standard practice for a Principal consultant to contact the investor, in advance of the maturity, to persuade the investor to renew his or her investment in one of the investments offered by the Principal group. These contacts were often made by telephone.

Some of the Principal consultants had permission from Principal Consultants Ltd. to renew the investment, or roll-over the investment, based on a telephone authorization. Copies of inter-office correspondence pertaining to the company's "Phone Selling procedures" are included in Appendix 11.10. This includes a document entitled "Phone Selling Procedures" (revised January 25, 1983). If the Principal consultant had "telephone privileges", the consultant was permitted to obtain the investor's permission, by telephone, to roll-over the maturing investment. In these circumstances, company policy did not require the application form to be signed personally by the investor. The space on the application form for the signature of the investor was stamped with the words "telephone privileges" and signed by the Principal consultant.

Part "A" of the "Regulation of Phone Selling" provided that the Principal consultant was only permitted to roll maturing investments into a Principal investment which the investor had previously purchased. The words of the Regulation are:

> "...the client must have purchased the same kind of product at least once before."

By way of example, assume that an investor had two investments. One was an investment in a term deposit certificate issued by Principal Savings and Trust Company which was insured by CDIC. The other was an investment contract issued by FIC. Also, assume that the Principal Savings and Trust Company term certificate was maturing. A Principal consultant, who had been granted "telephone privileges" by the Company, was permitted by Principal Consultants Ltd. to roll the investment into FIC/AIC without any written authorization from the investor. Principal Savings and Trust Company accepted this form of authorization to deal with its customers' funds. This practice had great potential for misuse by an unscrupulous Principal consultant who sought to earn a higher commission with respect to investments placed in FIC/AIC.

Part "B" of the company's "Regulation of Phone Selling" set forth the responsibilities of the Principal consultant. It provided:

> "Clients must have all features of the product fully explained, as would be the case with a 'face to face' sale, including:
>
> 1) CDIC or lack of it..."

Many investors, who had investments rolled over by telephone from Principal Savings and Trust Company to FIC/AIC, do not remember being advised of the lack of CDIC coverage with respect to the renewal of their investment. Indeed, their recollection is that they understood their investment was being renewed in the same investment, namely, a Principal Savings and Trust Company term deposit certificate.

12. REPRESENTATIONS MADE TO INVESTORS

The representations which were made to investors may be subdivided into various categories for the purpose of analysis. These categories are considered in Parts 12.1 to 12.7 of this Report. In some instances, several of the representations described below were made to one investor.

12.1 The Investment was "INSURED" in Some Manner:

Many investors reported to the Commission that a representation was made to them that their investment was insured. The various forms of this representation are described in greater detail below.

(a) The investment was insured by the Canada Deposit Insurance Corporation (hereinafter referred to as "CDIC":

Many investors reported that they thought that their investment was insured by CDIC. This is confirmed by the responses to the questionnaire which investors were requested to complete and return to the Commission. The questionnaire contained the following question:

> "13. Did you think that your investment was covered by Canadian Deposit Insurance Corporation?"

Almost fifty percent of the investors, who returned a questionnaire to the Commission, responded that they thought that their investment was insured by the Canada Deposit Insurance Corporation. It is significant that many of these investors had the same Principal consultant. Fifteen Principal consultants had 40 or more of the investors with whom they dealt report that they thought their investment was insured by CDIC and three of these agents had over 100 investors report that they thought that their investment was insured by CDIC.

Furthermore, three hundred and seventy-seven of the respondents to the questionnaire (20% of the respondents) were investors who had their investment "rolled over" from Principal Savings and Trust Company to either FIC/AIC and who thought that their investment was still insured by CDIC. These responses corroborate the submissions which were made to the Commission by individual investors, who were cognizant that their money was being transferred from Principal Savings and Trust to FIC/AIC. These investors allege that their Principal consultant did not explain the distinction, in terms of CDIC insurance, between a

"Principal Savings and Trust Term Deposit Certificate" and a "FIC/AIC Term Certificate" (an investment contract) when the investment was rolled over from Principal Savings and Trust to FIC/AIC.

The nature of the representation that the investment was covered by CDIC insurance and the manner by which the representation was made included the following:

(i) An express verbal representation by a Principal consultant that the investment was insured by CDIC when, in fact, the funds were being invested in either a FIC/AIC investment contract or a Principal Group Ltd. promissory note that was not insured by CDIC. A list of some of the investors who reported that this type of representation was made to them is included in Appendix 12.1(a) of this Report.

(ii) An implied representation by a Principal consultant that the investment was insured by CDIC. These implied representations arose after an investor made an explicit request or direction that any investment being made by the investor must be insured or covered by CDIC and, notwithstanding such directions, the Principal consultant arranged for the customer's funds to be invested in either a FIC/AIC investment contract or a Principal Group Ltd promissory note which was not insured by CDIC. A list of the investors who reported that this type of representation was made to them is included in Appendix 12.1(a) of this Report.

(iii) A verbal representation by a Principal consultant that the investment was "as safe as being in the bank" or "it is the same as a bank" when, in fact, the funds were being invested in either a FIC/AIC investment contract or a Principal Group Ltd. promissory note which was not insured by CDIC. A list of some of the investors who reported that this type of representation was made to them is included in Appendix 12.1(a) of this Report.

(iv) A verbal representation by a sales person or Principal consultant that all Registered Retirement Savings Plans (RRSP's) were covered by CDIC when in fact the RRSP plans operated by FIC/AIC were not insured by CDIC. A list of the investors who reported that this type of representation was made to them is included in Appendix 12.1(a) of this Report.

(v) A verbal representation by a sales person or Principal consultant that the presence of the CDIC sign, decal, or logo on the premises where the investment was being purchased, meant that all investments sold on the premises were covered by CDIC when, in fact, the funds were being invested in either a FIC/AIC investment contract or a Principal Group Ltd. promissory note which was not insured by CDIC.

None of the investment contracts offered by FIC/AIC were insured by CDIC.

I have not received any evidence from which an inference could be drawn that any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that these types of representation were being made by a significant number of the Principal consultants. The sheer number of investors who have reported that these types of representation were made to them raises the question of whether the senior management of these companies knew that these types of representations were being made or if they did not in fact know, whether they should have known that these representations were being made to customers. In the absence of better evidence from which an inference could be drawn that the companies or the senior management of the companies knew, or should have known, that these representations were being made by some of the Principal consultants, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made these types of representations, may be personally liable to the investor who acted upon them, to his or her detriment, is discussed in Part 17.1 of this Report.

Findings of Fact:

The representations described in subparagraphs (i) to (v) inclusive of Part 12.1 (a) of this Report were made to some investors. These representations caused those investors to be deceived and misled with respect to the security of their investments, and these representations were material representations upon which those investors acted to their detriment.

(b) Representation that CDIC could not be relied upon to provide insurance coverage for investors' deposits:

One investor reported that a verbal representation had been made to him by a Principal consultant that the Canada Deposit Insurance Corporation had "serious" financial problems and that the investor would be unwise to rely upon insurance provided by CDIC. The name of this investor who reported that this representation was made to him is included in Appendix 12.1(b) of this Report.

This representation was misleading and deceptive because the Canada Deposit Insurance Corporation is required by section 13 of the Canada Deposit Insurance Corporation Act, R.S.C. 1970, chap. C-3, to insure those deposits which come within the terms of that statute. There is no basis for suggesting that, in the event that the Corporation did not have sufficient funds derived from premiums to pay insured claims, that the Federal Government would not provide the funds pursuant to section 37 of the Act.

I have not received any evidence from which an inference could be drawn that any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by one or more Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Finding:

There is evidence that the representation described in Part 12.1 (b) of the Report was made to some investors.

(c) The Investment was Simply "Insured":

Some investors have reported that a verbal representation was made to them, by a Principal consultant, that their investment was simply "insured" without any details being given about the nature of the insurance. A list of the names of some of those investors who reported that this representation was made to them is included in Appendix 12.1(c) of this Report.

There is no evidence that the repayment to investors of the funds invested in investment contracts issued by FIC/AIC was insured in any manner.

I have not received any evidence from which an inference could be drawn that any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by one or more Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Findings of Fact:

The representation described in Part 12.1(c) of this Report was made to some investors. This representation caused those investors to be deceived or misled with respect to the security of the investment, and this representation was a material representation upon which those investors acted to their detriment.

(d) The Investment was Insured by "Principal" or the "Principal Group":

Several investors reported that a verbal representation was made to them, by a Principal consultant, that their investment contract with FIC/AIC, was insured by "Principal" or the "Principal Group", when it was not in fact insured. A list of the names of some of those investors who reported that this representation was made to them is included in Appendix 12.1(d).

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Findings of Fact:

The representation described in Part 12.1 (d) of this Report was made to some investors. The representation caused those investors to be deceived or misled with respect to the security of the investment, and these representations were material representations which those investors acted upon to their detriment.

(e) The Investment was Insured by a Bank:

Several investors reported that a verbal representation was made to them by a Principal consultant that the investment contract with FIC/AIC was insured by a bank when, in fact, it was not insured. The identity of the bank varied but was usually either the Royal Bank of Canada or the Canadian Imperial Bank of Commerce. The name of one of the investors who reported this representation was made to him is included in Appendix 12.1(e) of this Report.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Finding:

There is evidence that the the representation which is described in Part 12.1(e) of this Report was made to some investors.

(f) The Investment was Insured by Another form of Insurance other than CDIC:

A number of investors reported that a representation was made to them by a Principal consultant that their investment was insured by a form of insurance other than that which has been described above. A list of the names of some of the investors who reported that this representation was made to them is included in Appendix 12.1(f) of this Report.

In some of these instances, the representation appears to have stemmed from a misunderstanding of the effect of the Canadian and British Insurance Companies Act, R.S.C. 1970, chap. I-15.

In some instances, the investor may have misunderstood either what was said, or the effect of what was said, by the Principal consultant. For example, some investors reported that they understood that their investment was being insured by the "British North American Insurance Company" or the "International Insurance Fund".

In other instances, it is likely that the Principal consultant had an imperfect understanding of the function and effect of the Canadian and British Insurance Companies Act and the consultant transmitted this misunderstanding to the investor, thereby creating a misrepresentation. There is also some evidence that the Principal consultants may have received inaccurate information from one of the Principal Group of companies about the function and role of the Canadian and British Insurance Companies Act. A copy of an information sheet entitled "THE CANADIAN AND BRITISH INSURANCE COMPANIES ACT" is included in Appendix 12.1(f) of this Report. This document was provided to the Commission of Inquiry by Lorraine Carlson, who worked for a number of years in the Principal Financial Center located in Penticton, British Columbia, and who served from time to time as the manager of the Penticton office. This form was apparently generally available to Principal consultants working in that area and copies may have been provided to investors. It may be observed that the first paragraph of this document includes the following representation:

> "This acts as a type of insurance on deposits."

This statement misrepresents the effect of the Canadian and British Insurance Companies Act. This statute does not provide any form of insurance. One of the primary functions of the statute is to regulate the type of investments which may be made by insurance companies operating in Canada.

The above mentioned information sheet also includes the following representation:

> "It [the Canadian and British Insurance Companies Act] guarantees 104% of a term certificate for any amount, the securities are held for Principal in custody at the Royal Bank of Canada with First Investors Certificate, and the Canadian Imperial Bank of Commerce with Associated Investors."

This statement also misrepresents the effect of the Canadian and British Insurance Companies Act. This statute does not provide any form of guarantee in the sense that another agency or institution will repay the investor the amount of the investment contract if FIC/AIC failed to repay the investor. The names of some of the investors who reported that such a representation was made to them are set forth in Appendix 12.1(f).

A somewhat similar type of representation which tends to misrepresent the effect of the Act is a letter dated March 6, 1981, from Mr. Douglas S. Cant of Principal Consultants Ltd., to Mariette Plaissant. A copy of this letter is included in Appendix 12.1(f) of this Report.

Findings of Fact:

The representations described in Part 12.1(f) of this Report were made to some investors. These representations caused those investors to be deceived and misled with respect to the security of the investments, and these representations were material representations upon which those investors acted to their detriment.

(g) That FIC/AIC were the same as Insurance Companies:

Several investors reported to the Commission that they were told, by a Principal consultant, in response to an inquiry by the investor concerning the security of the investment that FIC/AIC were the same as an insurance company. This type of representation took several different forms. The representation was not explicitly that the investment was insured, but rather that an investment in FIC/AIC was as safe as an investment with an insurance company or that FIC/AIC were governed by the same law as insurance companies. It is convenient to deal with this representation at this point in this Report because the representation relates, in part, to the subject matter that was discussed in the immediately preceding section of this Report. A list of the names of some of the investors who reported that this representation was made to them is included in Appendix 12.1(g).

One of the forms of this type of representation is illustrated by a letter dated April 11th, 1986, on Principal Consultants Ltd. letterhead, from Martin E. King, Senior Account Executive in Edmonton, and addressed to Mrs. Leone Taylor in Prince Rupert, British Columbia. A copy of this letter is included in Appendix 12.1(g) of this Report. The second paragraph of this letter begins with the following two sentences:

> "Firstly, your investments are of two different natures. The one being interest bearing Certificates that are regulated under the 'Investment Contracts Act' which is the same Act that Governs all insurance companies."

This statement is a misrepresentation because insurance companies are regulated under entirely different legislation and because the regulation of insurance companies is materially different than the regulation of investment contract companies.

Findings of Fact:

The representations described in Part 12.1 (g) of this Report were made to some investors. These representations caused those investors to be deceived and misled with respect to the security of the investments, and these representations were material representations upon which those investors acted to their detriment.

12.2: The Investment was Guaranteed in Some Manner:

Many investors reported that a representation was made to them that their investment was guaranteed. The various forms of this representation are described in greater detail below.

(a) The Investment was Guaranteed by Principal Group Ltd.

Many investors reported that a verbal representation was made to them, by a Principal consultant, that their investment was guaranteed by Principal Group Ltd. Four hundred and forty-eight of the investors who returned a questionnaire to the Commission (24% of the respondents) responded that they had been told that Principal Group Ltd. was guaranteeing their investment.

(b) The Investment was Guaranteed by the Principal Group or the Principal Group of Companies

Five hundred and eleven of the investors who returned a questionnaire to the Commission (27% of the respondents) responded that they had been told that the Principal Group of Companies were guaranteeing their investment. Many of the investors who fall within either Part 12.2(a) or 12.2(b) do not clearly recall whether the representation described in these Parts pertained to "Principal Group Ltd.", "Principal Group", or the "Principal Group of Companies". Therefore, the names of the investors who reported any of these representations have been incorporated into the list which is included in Appendix 12.2(b).

Findings of Fact:

The representation described in Part 12.2(a) and (b) of this Report were made to some investors. These representations were material representations with respect to the security of the investment upon which those investors acted when deciding to make or renew their investment.

(c) The Investment was "Guaranteed" or "Backed" by "Principal"

Some investors reported that a verbal representation was made to them, by a Principal consultant, that their investment was guaranteed simply by "Principal". In some instances, investors were provided with a statement on Principal Consultants Ltd. stationery bearing the heading "Two Types of Guarantees". A copy of this letter is included in Appendix 12.2(c) of this Report.

Other investors reported that a verbal representation was made to them by a Principal consultant that their investment was "backed" by the Principal Group. Although the word "guarantee" was not explicitly used in making this version of the representation, the implicit message was, that if anything happened to FIC/AIC, the Principal Group and its assets would be available to repay the investors. A list of some of the names of investors who reported that one of these types of representation was made to them is included in Appendix 12.2(c) of this Report.

Findings of Fact:

The representations described in Part 12.2(c) of this Report were made to some investors. These representations were material representations with respect to the security of the investment upon which those investors acted when deciding to make or renew their investment.

(d) The Investment was Guaranteed by Principal Savings and Trust Company

Four hundred and forty-nine of the investors who returned a questionnaire (24% of the respondents), responded that they had been told that Principal Savings and Trust Company was guaranteeing their investment. A list of some of the names of investors who reported that this representation was made to them is included Appendix 12.2(d) of this Report.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence, from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Finding:

There is some evidence that the representation described in Part 12.2(d) of this Report was made to some investors. These representations caused those investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which those investors acted to their detriment.

(e) The Guarantee Offered by FIC/AIC was as Good or Better than CDIC

Some investors reported that a verbal representation was made to them, by a Principal consultant, that the guarantee offered by FIC/AIC was as good or better than that offered by the Canada Deposit Insurance Corporation. The primary reason given by the consultant as to why the FIC/AIC guarantee was better, was that the FIC/AIC guarantee was not subject to the $60,000 maximum limitation of CDIC insurance. Therefore, investors were advised that they could keep all of their funds with Principal rather than spread them among several financial institutions. A list of some of the names of investors who reported that this type of representation was made to them is included in Appendix 12.2(e) of this Report.

Findings of Fact:

The representations described in Part 12.2(e) of this Report were made to some investors. These representations caused those investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which those investors acted to their detriment.

(f) The Investment was Guaranteed by Either the Royal Bank, the Canadian Imperial Bank of Commerce or a Chartered Bank

Many investors reported that a verbal representation was made to them, by a Principal consultant, that their investment was guaranteed by the Royal Bank, the Canadian Imperial Bank of Commerce or a chartered bank when, in fact, it was not. Five hundred and sixty-two of the investors who returned a questionnaire to the Commission (30% of the respondents), responded that they were told that their investment was guaranteed by a bank or financial institution. A list of some of the names of investors who reported that this representation was made to them is included in Appendix 12.2(f) of this Report.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Findings of Fact:

The representations described in Part 12.2(f) of this Report were made to some investors. These representations caused those investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which those investors acted to their detriment.

(g) The Investment was Guaranteed by the Bank of Canada

A few investors reported that a verbal representation was made to them by a Principal consultant that their investment was guaranteed by the Bank of Canada when, in fact, it was not. A list of some of the names of investors who reported that this representation was made to them is included in Appendix 12.2(g) of this Report.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Finding:

There is evidence that the representation described in Part 12.2(g) of this Report was made to some investors.

12.3: Representations made about Financial Assurances of the Alberta Government

Some investors reported that representations were made to them that their investment was in some manner protected by the Government of Alberta. This representation took several forms. The various forms of this representation are described below.

(a) The Investment was Insured or Guaranteed by the Alberta Government

Some investors reported that a verbal representation was made to them by a Principal consultant that their investment was insured or guaranteed by the Alberta Government. A list of some of the names of investors who reported that this representation was made to them is included in Appendix 12.3(a) of this Report.

I am not aware of any evidence which would support the representation described in the preceding paragraph.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence, from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Findings of Fact:

The representations described in Part 12.3(a) of this Report were made to some investors. These representations caused those investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which those investors acted to their detriment.

(b) The Alberta Government Guaranteed that Funds were on Deposit with a Chartered Bank

A few investors reported that a verbal representation was made to them, by a Principal consultant, that the Government of Alberta guaranteed that funds invested in investment contracts were deposited with either the Royal Bank of Canada or the Canadian Imperial Bank of Commerce. A list of some of the names of investors who reported that this representation was made to them is included in Appendix 12.3(b) of this Report.

I am not aware of any evidence which would support the representation described in the preceding paragraph.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it to his or her detriment is discussed in Part 17.1 of this Report.

Findings of Fact:

The representations described in Part 12.2(b) of this Report were made to some investors. These representations caused investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which the investors acted to their detriment.

(c) Promissory Note Covered by an Alberta Government Bond

At least one investor who purchased a Principal Group Ltd. promissory note reported that a verbal representation was made to her by a Principal consultant that the promissory note was "covered by an Alberta Government Bond". The name of the investor who reported that this representation was made to her is included in Appendix 12.3 (c) of this Report.

I am not aware of any evidence which would support the representation described in the preceding paragraph.

I have not received any evidence from which an inference could be drawn that the any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that this type of representation was being made by some of the Principal consultants. In the absence of evidence from which such an inference could be drawn, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made this type of representation, may be personally liable to the investor who acted upon it, to his or her detriment, is discussed in Part 17.1 of this Report.

Finding:

There is evidence that the representation described in Part 12.3(c) of this Report was made to at least one investor.

12.4: Representation that Cash Deposited With Bank

Many investors reported that a verbal representation was made to them, by a Principal consultant, that funds equal to the liabilities of FIC/AIC were kept on deposit in a chartered bank. Seven hundred and twenty of the investors who returned a questionnaire to the Commission (38% of the respondents), responded that they believed their investment was secure because their funds were kept on deposit with a chartered bank. A list of the names of some of the investors who reported that this representation was made to them is included in Appendix 12.4 of this Report.

A typical experience of an investor within this group may be found in the testimony of Stanley John Nemrava, whose testimony was taken before me on September 1, 1987. At page seven of the transcript of his testimony, Mr. Nemrava described the conversation he had with his Principal consultant as follows:

> "...every dollar you invest dollar for dollar is placed into a chartered bank in Alberta..."

In fact, funds equal to the total amount of the investment contracts issued by FIC/AIC were not kept on deposit in a chartered bank.

I have not received any evidence from which an inference could be drawn that any of the Principal Group of companies authorized the making of this type of representation, or that the senior management of any of these companies knew that these types of representation were being made by a significant number of the Principal consultants. The sheer number of investors who have reported that these types of representation were made to them raises the question of whether the senior management of these companies did know that these types of representations were being made or, if they did not in fact know, whether they should have known that these representations were being made to customers. In the absence of better evidence from which an inference could be drawn that the companies or the senior management of the companies knew, or should have known, that these representations were being made by some of the Principal consultants, none of the Principal Group of companies could be held vicariously liable for these types of misrepresentations by Principal consultants. The issue of whether or not the Principal consultants, who made these types of representations, may be personally liable to the investor who acted upon them, to his or her detriment, is discussed in Part 17.1 of this Report.

Findings of Fact:

> The representations described in Part 12.4 of this Report were made to some investors. These representations caused those investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which those investors acted to their detriment.

12.5: Representations about Investment Portfolio

Many investors reported that representations were made to them about the nature of investment portfolio which FIC/AIC or Principal Group Ltd. held at the time when they made their investment. These representations took different forms. Some of the forms of this representation are described below.

(a) That the Largest Portion of FIC/AIC's Investment Portfolio Consisted of "Safe Fixed-Income Investments"

One of the most common representations was that the largest portion of FIC/AIC's investment portfolio consisted of "safe fixed-income investments". Evidence that this representation was authorized by Principal Consultants Ltd. may be found in a document published by Principal Consultants Ltd. entitled:

"Section II
PRINCIPAL PORTFOLIO PRESENTATION"

A copy of this document is included in Appendix 12.5(a) of this Report. The footnotes to this document suggest how a Principal consultant should respond to a question from a prospective customer on this topic:

"(1.) Should a client ask what the safe-fixed income investments are, here is your response:

> Our safe-fixed income investments consist primarily of thousands of well-secured, low ratio first mortgages across the country. This means that we protect our client's investments with a diversified portfolio that is not overly dependent on one area of the country and where the mortgage is much lower than the appraised value or purchase price of the property that secures the mortgage."

There is no date of this publication; however, there is evidence that for most of the last five years, most of the mortgages held by FIC/AIC were in Alberta. A substantial percentage of these mortgages were non-performing in the sense that mortgagors were not making the payments required by the mortgages.

(b) Representations that FIC/AIC did not have Significant Investments in Real Estate

Another common representation with respect to the investment portfolio of FIC/AIC was that these companies did not have significant investments in real estate. A list of the names of some of the investors who reported this representation was made to them is included in Appendix 12.5(b).

In fact, Coopers & Lybrand have reported in the Plans of Arrangement for FIC/AIC, that both of these companies had substantial holdings in real estate at June 30, 1987, albeit that many, and perhaps most, of these holdings had been obtained by way of foreclosure of mortgages held by the companies. These holdings amounted to:

FIC = "book value" in excess of $92 million.
AIC = "book value" in excess of $23 million.

(c) Representations that FIC/AIC did not have Significant Investments in Mortgages

Another common representation with respect to the investment portfolio of FIC/AIC was that these companies did not have significant investments in mortgages. A list of the names of some of the investors who reported this representation was made to them is included in Appendix 12.5(c).

In fact, Coopers & Lybrand have reported in the Plans of Arrangement for FIC/AIC, that both of these companies had substantial mortgage holdings at June 30, 1987. These holdings amounted to:

FIC = "book value" in excess of $40 million.
AIC = "book value" in excess of $11 million.

(d) Representations that FIC/AIC had the Major Portion of their Investments in Blue Chip Stocks and Government Bonds

Another common representation with respect to the investment portfolio of FIC/AIC was that these companies had the major portion of their investments in blue chip stocks and government bonds. A list of the names of some of the investors who reported this representation was made to them is included in Appendix 12.5(d).

In fact, Coopers & Lybrand have reported in the Plans of Arrangement for FIC/AIC on the marketable securities held by both of these companies at June 30, 1987.

FIC: The value of marketable securities amounted to almost $39 million dollars whereas the shares held in related Principal Group companies had a "book value" in excess of $48 million dollars.

AIC: The value of marketable securities amounted to almost $33 million dollars whereas the shares held in related Principal Group companies had a "book value" in excess of $21 million dollars.

Findings of Fact:

The representations described in Part 12.5 of this Report were made to investors. These representations caused investors to be deceived or misled with respect to the security of the investment, and these representations were material representations upon which those investors acted to their detriment.

12.6: Representations Pertaining to Promissory Notes Issued by Principal Group Ltd.

Principal Group Ltd. sold promissory notes to investors. These notes were also marketed by Principal consultants who worked for Principal Consultants Ltd.

Prior to purchasing their respective promissory notes, some of these investors, who were concerned about the investment portfolio of Principal Group Ltd., requested more information about the promissory notes and about the investment portfolio of Principal Group Ltd.

In response to such requests, some of these investors received a glossy brochure with the heading "PRINCIPAL" and the title "Information Memorandum Short and Medium Term Promissory Notes". The Commission has received copies of several different editions of this brochure. The content of each edition is substantially the same. I am unable to find anything in this document which is deceptive or misleading.

In response to the requests referred to above, some investors requested a copy of the "Annual Review" or "Annual Report" of the Principal Group. These documents are considered in Part 12.7(b) and (c) of this Report.

Another document which was provided to some prospective purchasers of promissory notes is a document with the heading "PRINCIPAL GROUP LTD." and bearing a reference in the lower right hand corner to "Form 950". A copy of this document is included in Appendix 12.6 of this Report. This document refers to the "Average Investment Mix for Principal Group Ltd. for the past seven years", and states that 47 % of the investments held by the company were in:

> "SAFE - FIXED INCOME INVESTMENTS
> Assets Secured by Real Estate"

There is no date on this document but the last year referred to on the document is 1982. Therefore, it may be inferred that the document was prepared by Principal Group Ltd. in the year 1982 or later. I have not ascertained whether this information was accurate. The business records of Principal Group Ltd. are located in Alberta, and they have not yet become available for scrutiny. I expect that these records will become a matter of public record either as part of the Inquiry being conducted in the Province of Alberta by Mr. William Code, Q.C., or in the bankruptcy proceedings of Principal Group Ltd.

If an investor decided to purchase a promissory note, an application form was completed by the Principal consultant. Several different forms of application were used at different times. The "application" part of this form contains the following statement in bold black print:

> "PRINCIPAL GROUP LTD. PROMISSORY NOTES are not covered by Canada Deposit Insurance Corporation."

The application form had several parts. The top part consisted of the application to purchase the promissory note. Below the application form was a tear-off portion which appears to be a Report intended to be filed pursuant to the Alberta Securities Act. Below this, again, was another tear-off form under the heading Principal Trust. The latter portion served as a signature card for an account with Principal Savings and Trust Company and bore the heading "Principal Trust". One of the requirements of the Principal Group of companies was that every investor, regardless of the type of investment which was made, must open and maintain a chequing account with Principal Savings and Trust Company. On several versions of the Application Form, the tear-off signature card bore the name "Principal Trust". A copy of this type of form is included in Appendix 12.6 of this Report. On apparently more recent versions, the reference to "Principal Trust" was omitted from the bottom tear-off portion. In Part 12.7(a) of this Report there is a detailed criticism of including a Principal Trust signature card as part of an application form for the purchase of a FIC/AIC investment contract. The same criticism applies to including a Principal Trust signature card as part of an application form for the purchase of a Principal Group Ltd. promissory note.

12.7: Representations made in Forms and Other Publications of the Principal Group of Companies.

(a) Application Forms

Since the year 1980, FIC/AIC have provided several types of application forms to Principal consultants for use with respect to the purchase of an investment contract issued by FIC/AIC. Many investors have alleged that various aspects of these application forms misled or deceived them.

One of the complaints by investors who thought that they were dealing with Principal Savings and Trust Company, is the fact that the standard application form for the purchase of an investment contract from FIC/AIC had a "tear-off portion on the bottom, which was a signature card for an account with Principal Savings and Trust. Several former Principal consultants and Principal managers advised the Commission that one of the requirements of the Principal Group of companies was that every investor, regardless of the type of investment which was made, must open and maintain a chequing account with Principal Savings and Trust Company. In order to implement this policy, every version of an application form contained a tear-off signature card. On the versions of the application form which were used in the early 1980s, the bottom tear-off portion bore the heading of "Principal Trust" in bold black lettering. An example of this version of the form, bears the identification "Form 880 (REV. 11/80)" in the lower left hand corner of the application form. A copy of this version is included in Appendix 12.7(a) of this Report.

On other, and apparently more recent versions, the reference to "Principal Trust" was omitted from the bottom tear-off "signature card" portion of the application form. A copy of this type of form is included in Appendix 12.7(a) of this Report.

Findings of Fact:

> Those versions of the application form, where the bottom tear-off signature card bore the name "Principal Trust", had a tendency to mislead investors into believing that they were purchasing a term certificate from Principal Savings and Trust, which was a member of the Canada Deposit Insurance Corporation, particularly when this form was used in the context of the business practices which are described elsewhere in this Report.

Another aspect of the application form, which many investors now assert misled, them is a statement which appeared on the upper left hand corner of back of most versions of the application form. The form of application which bears the identification "Form 880 (Rev. 2/84)", contains the following version of the statement:

> "Assets equal to 100% of certificate liabilities are maintained on deposit with a chartered bank"

This statement closely parallels the language of the Investment Contract Act. Investors have asserted that they understood the statement on the application form to mean that money was on deposit in a chartered bank. Some investors were probably led to this interpretation by Principal consultants who also believed that money or funds equal to 100% of the certificate liabilities were maintained on deposit with a chartered bank. Reference to such representations by Principal consultants are contained in Part 12.4 of this Report.

Another aspect of the application form which deserves some comment is the placement of the notice on the application form which notified the purchaser that investment contracts were not insured by the Canada Deposit Insurance Corporation. The form of application which was in use in late 1980 and 1981, was a form bearing the following identification "Form 880 REV. 11/80", on the lower left hand portion of the application form. A copy of this form is included in Appendix 12.7(a) of this Report. This form did not bear any language on its face to warn investors that an investment with FIC/AIC was not insured by CDIC. A statement to this effect did appear on the back of the form in the upper left hand corner, along with a whole page of other fine print. There was a space, on the lower portion of the back of the form, for the signature of the investor and by signing in the space provided, the investor purported to acknowledge that:

> "The above terms have been fully review with me by the consultant and the initials above indicate that I fully understand the explanation."

I have not seen a copy of this form where the investor initialled the boxes provided on the back of the application form. The practice of some consultants was for the consultant to place a check mark in the box beside the terms which had been explained to the investor. In many cases, none of the boxes were either initialled or checked.

A revised version of the application form was used beginning in 1981. This version bears the identification "Form 880 (Rev. 5 81)", in the lower left portion of the application form. A copy of this form is included in Appendix 12.7(a) of this Report. This version of the "application" part of the Application Form contained the following notice:

> "Certificates offered on this application are not covered by the provisions of the Canada Deposit Insurance Corporation."

This notice appeared in fine print on the bottom of the application form, and is separated from the space provided for the investors signature by several lines and boxes which were intended for use by the consultants in calculating their commission.

Subsequent versions of the application form printed the notice which is quoted in the preceding paragraph in bolder black print. The version which appears to have been in use since mid-1985, and which bears the identification "Form 880 Rev. 6/85", on the lower left portion of the application form, contained the words:

> "INVESTMENT CONTRACTS ARE NOT INSURED BY CANADA DEPOSIT INSURANCE CORPORATION"

printed in bold red letters in the left hand column about two inches above the space provided for the purchaser's signature. A copy of this form is included in Appendix 12.7(a) of this Report. Although this notice was not as close to the space provided for the purchaser's signature as it could have been, I think that it would be difficult to persuade a court that an observant investor who signed the application form would not have seen the notice on this latter version of the application form.

Although criticisms may be made about the language used on the application forms, many investors did not read the forms before signing them and, in some cases, the forms were signed in blank, with the investor relying upon the Principal consultant to complete the form in accordance with the investor's instructions. This was a practice that was encouraged by some of the Principal consultants. I shall be making some recommendations later in this Report about the content of application forms, but I am not confident that changes in the content of an application form will prevent other persons in the future from being misled when they do not carefully read the application form.

(b) Annual Reviews

In 1986, "Principal" published a document entitled "Principal Group 31st Annual Review 1985". The Annual Review contains 45 pages of glossy paper appears to be similar in form and content to the "Annual Reports" which were published in previous years. However, there are some important distinctions between the two types of documents. The 1985 Annual Review does not reproduce any audited financial statements for any of the Principal Group of companies. It does contain a "Condensed Summary of Operations", which is consolidated for all of the Principal Group of companies, for the ten year period 1976 - 1985, but it does not contain any financial statements with respect to individual companies. It also contains some descriptive commentary with respect to several of the Principal Group of Companies including First Investors Corporation Ltd., Associated Investors of Canada Ltd., Principal Savings and Trust Company, and Principal Consultants Ltd.

The 1985 edition of the Annual Review was provided to some investors who hold promissory notes issued by Principal Group Ltd. and to some investors who hold investment contracts in FIC/AIC. A list of some of the investors who received a copy of this document prior to making their respective investments and who relied upon the representations contained in the document, is included in Appendix 12.7(b) of this Report.

This edition of the Annual Review contains representations with respect to the portfolio of investments held by FIC/AIC. The following representation is found at page 16 of the document:

> "Corporate investments are currently concentrated in bonds and securities offering excellent liquid returns. Because of the need for a balanced portfolio of secure investments, a large part of these companies' assets are in government and corporate bonds as well as blue chip stocks."

A copy of this page of the Annual Review is included in Appendix # 12.7(b) of this Report. There is no reference in this representation to mortgages or real estate held by FIC/AIC as part of their investment portfolios. The audited financial statements of First Investors Corporation Ltd. for the period ending December 31, 1985, (which is the corresponding period), state that the mortgages held by First Investors Corporation Ltd. amounted to $103,813,308. This represented approximately 30% of the total assets of the company. The audited financial statements of Associated Investors of Canada Ltd. for the period ending December 31, 1985, depict a similar pattern.

Findings of Fact:

I find that the representations on page 16 of the 31st Annual Review pertaining to the investment portfolios of FIC/AIC were misleading.

(c) Annual Reports

It is interesting to compare the 1985 Annual Review described above with the Annual Reports described below. The Annual Reports contained both an Auditor's Report, a Consolidated Balance Sheet, a Consolidated Statement of Income, and a Consolidated Statement of Changes in Financial Position. These did not appear in the 1985 Annual Review.

(i) Principal Group Ltd. Annual Report 1984

The 1984 Annual Report contains 29 pages of glossy paper. Page 10 contains the following statement:

> "The company has appropriated shareholder's equity of approximately $10 million to cover potential losses on real estate and mortgages should the recovery in western Canadian real estate markets be slower than anticipated."

A copy of page 10 is included in Appendix 12.7(c) of this Report.

(ii) Principal Group Ltd. Annual Report 1980

The Report contains 37 pages of glossy paper. Pages 22 and 23 contain statements that mortgages represent 45.2% of First Investors total assets and that Associated Investor's maintains its certificate reserves and assets largely in the same proportions as First Investors. A copy of page 37 is included in Appendix 12.7(c) of this Report.

(iii) Principal Group Ltd. Annual Report 1979

The Report contains 33 pages of glossy paper. Page 19 contains the following statement:

> "The net result is that both companies have a high degree of liquidity in non-mortgage investments in addition to well positioned mortgage portfolios in terms of yield and value."

A copy of page 19 is included in Appendix 12.7(c) of this Report.

The consolidated financial statements do not contain any details with respect to the assets or liabilities of FIC/AIC.

(d) Brochures

Various types of brochures were distributed by Principal consultants to prospective investors. Some of these contained representations which were misleading or tended to mislead investors.

(i) Brochure entitled "The Principal Story"
A copy of this brochure is included in
Appendix 11.4 of this Report.

This brochure contains the following paragraph:

> "Principal Trust is a member of the Canada Deposit Insurance Corporation and the Trust Companies Association of Canada. The company also acts as Trustee for all the member companies' RRSP investments." [emphasis added by way of underlining]

There are two representations contained in the quotation. The first representation is that Principal Savings and Trust served as the Trustee for the RRSP plans of all Principal Group companies including FIC and AIC. The second representation flows from the proximity of the two sentences in the statement quoted above. The implication is that funds invested in an RRSP plan with any of the Principal Group of companies, including FIC/AIC, are insured by the Canada Deposit Insurance Corporation. In fact, CDIC coverage only extended to funds deposited directly by the investor with Principal Savings and Trust Company under one of its RRSP plans.

Findings of Fact:

The representations contained in the above quotation from this brochure were misleading, notwithstanding that at a later point in the brochure there is a statement under the heading of First Investors Corporation Ltd. (FIC), and Associated Investors of Canada Ltd. (AIC) that:

> "THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION."

These representations caused investors to be deceived or misled with respect to the security of the investment which the investors were considering, and these representations were material representations upon which the investors acted when deciding to make or renew their investments.

The reverse side of this brochure contains text under the heading "History". Although the text begins with a reference to Principal Group Ltd., it immediately evolves into a discussion of FIC/AIC. The column concludes with a description of how "...the company has invested its assets over the past six years", and sets forth the percentage of various forms of assets. The use of the word "company" in this text in relation to the investment of assets is ambiguous. The term "company" can be construed to refer to either FIC/AIC or Principal Group Ltd., or perhaps even the whole Principal Group of companies. Nevertheless, it would not be unreasonable for a prospective investor to understand the reference as being to FIC/AIC. There is no reference to mortgages or holdings in real estate in the summary of the investment portfolio.

There is a line in the summary which reads:

"Safe-Fixed Income Investment 45 %"

There is no definition of what is meant by "Safe-Fixed Income Investment". The reader of the brochure is left to speculate about the meaning. There are several types of investments which could fall within the term "safe-fixed income investment". One example would be Government of Canada Treasury Bills. In fact, a present analysis of the companies' holdings reveals that the reference in the brochure to "Safe-Fixed Income Investment" referred to investments in mortgages.

Findings of Fact:

The representations contained in this brochure under the heading "History", as quoted above, were misleading, and caused investors to be deceived or misled with respect to the security of the investment which the investors were considering. These representations were material representations upon which the investors acted when deciding to make or renew their investments.

(e) Monthly Statements of Account issued by Principal Group Ltd.

Every person who held an investment in any one of the Principal Group of companies received a monthly statement. The recent versions of these monthly statements bore the heading "Principal Group of Companies". The member companies are listed underneath the heading. The statement directed the recipient to report any discrepancy in the statement to Principal Group Ltd. The monthly statement recorded the status of each investment and each account with Principal Savings and Trust Company. This statement contained a record of any transactions which had occurred with respect to an investment since the date of the last statement. The document was also used from time to time as a means of advertising various Principal investments and services.

13.0: BUSINESS PRACTICES WHICH TENDED TO A DECEIVE INVESTORS

This part of the Report will deal with several business practices used by the companies named in the Minister's Order or their respective employees or agents which contributed to the deception of some investors.

Before identifying specific business practices, it will be useful to describe a scenario which has reported to the Commission by a significant number of investors. These reported that they went to a Principal Savings and Trust Company branch with the intention of purchasing a term certificate offered by Principal Savings and Trust Company. In many of these cases, these investors were attracted to Principal Savings and Trust Company by a newspaper advertisements published by the Company which advertised the availability of term deposit certificates and which advertised that the Company was a Member of the Canada Deposit Insurance Corporation. Upon their arrival at a branch of Principal Savings and Trust, a person who appeared to a member of the staff of Principal Savings and Trust dealt with the investor and completed an application form which the investor was requested to sign. In some of these cases, the investor specifically referred to the above mentioned advertisement during the course of the discussions. When the application form had been completed, the investor would write a cheque for the amount of the term certificate. The cheque was usually made payable to either "Principal Trust" or "Principal Plans". These investors report that during all of this process there was no mention of either FIC/AIC. In some cases, the investor accompanied the Principal consultant back to the Principal Savings and Trust Company counter or receptionist where the application form and the investor's cheque were submitted. The investor had initially come in to the counter of Principal Savings and Trust Company and left the premises after leaving his or cheque payable to Principal Plans or Principal Trust at the same counter. The circle was now complete and, in many cases, the investor had never become aware that he or she had dealt with Principal Consultants Ltd or one its consultants and had applied to purchased an investment in a company other than Principal Savings and Trust Company.

In the circumstances described in the preceding paragraph, the application form which most of the investors signed bore the heading quoted below:

> "First Investors Corporation Ltd,
> Associated Investors of Canada Ltd."

The names of the two companies appeared in the upper left hand corner of the application form. Most of the investors in this category simply state that they did not notice the name at the top of the application form. If another form such as Revenue Canada Form T-2033 was attached to the top of the application form by means of a paper clip in the upper left hand corner and the Revenue Canada form was folded over after it had been signed by the investor, the names of FIC/AIC would not be visible. Some of the other characteristics of the application form, including the bottom portion which was a signature card for a Principal Savings and Trust Company account, are discussed in Part 12.7(a) of this Report.

Many of the investors had their cancelled cheques which represented their respective investments returned to them and they have provided copies of these cancelled cheques to the Commission. All of the cancelled cheques which have been submitted to the Commission indicate by the markings on the back of the cheque that the cheque had been deposited to the credit or Principal Savings and Trust Company. When the investor received the cancelled cheque back from his or her bank, this reaffirmed, in the minds of the investors, that their investment was in a Principal Savings and Trust Company term deposit certificate.

The first document which the investor would usually receive from the head office of the Principal Group of Companies was a document called a "Confirmation Receipt". A sample of this document is included in Appendix 13.0 of this Report. One side of this document prominently displayed the name "Principal" and listed the names of several of the Principal Group of companies including Principal Savings and Trust Company. The details of the investment which the investor had purchased were printed on the reverse side including the name of the company which held the investment. A careful examination of this document would reveal the true status of the investment. Some of the investors who heretofore had not realized that their funds had been invested with FIC/AIC, did address inquiries to the Principal consultant who had dealt with them. Various responses were received from the Principal consultants. In some instances, the investors was told that FIC/AIC were merely the names that were attached to these particular term certificates. In other instances, the investors were told that it was too late to make any change. In a very few cases, if the investor was extremely insistent, the investment of the funds was transferred from FIC/AIC to Principal Savings and Trust Company.

13.1: The Practice of Not Making a Clear Public Demarcation between Principal Savings and Trust Company and Principal Consultants Ltd.

The practice of not making a clear public demarcation between Principal Savings and Trust Company and Principal Consultants Ltd. was manifested in the ways described below.

(a) The practice permitting the premises occupied by Principal Savings and Trust Company to be used by Principal Consultants Ltd., without any clear public demarcation between the operations of the two companies

At those locations in British Columbia where Principal Savings and Trust Company maintained a branch, the premises were also used by Principal Consultants Ltd. for the purpose of marketing a range of investments offered by the Principal Group of Companies. In most locations, there was no public demarcation between those parts of the premises used by the two companies. Furthermore, there was no public identification of those members of the staff who worked in these locations with respect to whether they were associated with Principal Savings and Trust Company or Principal Consultants Ltd. Consequently, a member of the public, who entered a branch of Principal Savings and Trust Company for the first time, would reasonably assume that he or she was dealing only with Principal Savings and Trust Company. This is reflected in the testimony of Charlotte Ruta who was the manager of the branch of Principal Savings and Trust Company in Kelowna, British Columbia from December, 1980 until June 1986. Beginning at line 46 on page 3 and continuing until line 21 of page 4 of the transcript of her testimony the following questions and answers may be found:

"Q Again when the investor or new investor or potential investor came in off the street and saw the receptionist and then the receptionist would refer that individual to one of the Principal consultants -

A Yes.

Q - was such a potential investor advised, to your knowledge, of the fact that he or she was being passed over from a Principal Savings and Trust operation to a Principal Consultants Ltd. operation?

A No, I don't think in all the time I was there I never heard that announcement made.

Q Again to your knowledge, and within your hearing, would the receptionist advise the potential investor, new investor when he or she came in that "I'm introducing you to Mr. Smith from Principal Consultants Ltd."?

A Not to my knowledge, she would say "I will have Mr. Smith look after you or answer your questions."

Q So it would be difficult for a new investor walking into Principal Savings and Trust to ascertain that he or she was now dealing with Principal Consultants Ltd.?

A He would have no way of knowing. He didn't leave the room, he would walk maybe 6 feet at the most."

I do not attach any blame to Charlotte Ruta whatsoever for the adoption of this practice. The practice was clearly a business practice that was a matter of corporate policy.

Finding of Fact:

The business practice described in Part 13.1 (a) of this Report caused investors to be misled or deceived with respect to the the identity of the company with which the investor was dealing.

(b) The practice of referring prospective customers of Principal Savings and Trust Company to Principal Consultants Ltd.

When prospective customers of Principal Savings and Trust Company entered one of their branches, and expressed a desire or interest in purchasing a term deposit certificate (this type of investment would have been insured by CDIC), the standard practice was to refer the prospective customer to a "Principal consultant" who was employed by Principal Consultants Ltd. This practice is clearly described in the testimony of Charlotte Ruta, who was the manager of the Kelowna branch of Principal Savings and Trust Company from December, 1980 until June, 1986. Beginning at line 17 on page 8 and continuing until line 22 of the transcript of her testimony, she states:

> "There was an unwritten rule between Principal Consultants and Principal Savings and Trust that all investment customers would be referred to a consultant at all times whether the customer wanted a Principal Savings and Trust term deposit or other information."

A similar practice was followed in other branches in British Columbia. This practice was followed by Principal Savings and Trust Company with the knowledge that the Principal consultants were also selling other investments which were not insured by CDIC and upon which the Principal consultants received a higher rate of commission.

Finding of Fact:

The business practice described in Part 13.1 (b) of this Report caused investors to be misled or deceived with respect to the the identity of the company with which the investor was dealing.

(c) The practice of directing that cheques for the purchase of a FIC/AIC investment contract be made payable to either "Principal Plans" or "Principal Trust"

Notwithstanding that a Principal consultant had completed an application form on behalf of an investor for the purchase of an investment contract in FIC/AIC, the investor was directed to make the cheque payable to either "Principal Plans" or "Principal Trust" rather than FIC/AIC. This direction to make cheques payable to "Principal Plans" was reduced to writing in some instance. Therefore, if it had not been brought to the investor's attention during the discussions with the Principal consultant that the investor's funds were being invested in FIC/AIC, the direction to make the cheque payable to either Principal Trust or Principal Plans would not bring the true identity of the investment to the investor's attention. There is no reason why investors' cheques should not have been made payable to either FIC/AIC. The fact that investors were not directed to make their cheques payable to the company in which they were making their investment served, in many cases, to complete non-disclosure to the investor of the true nature of the investment which the investor was making. Regardless of the name of payee, the cheques were deposited to the credit of Principal Savings and Trust Company.

Finding of Fact:

The business practice described in Part 13.1 (c) of this Report caused investors to be misled or deceived with respect to the the identity of the company in which their funds were being invested.

(d) The practice of filling out the Revenue Canada form, T 2033, to show Principal Trust as being the transferee of an RRSP being transferred from another financial institution when, in fact, the RRSP was being transferred to FIC/AIC

In order to transfer a Registered Retirement Savings Plan from one financial institution to another, it is necessary for the owner of the plan to sign and file a notice of transfer with Revenue Canada. The form designated by Revenue Canada for this purpose is known as Form T 2033. A sample of this form is included in Appendix 13.1 (d) of this Report. This form is usually completed by the financial institution to which the RRSP is being transferred and presented to the investor for signature. This was the practice followed at the offices of Principal Consultants Ltd. On this form there is a space for the name of the transferee. In those cases where the Principal consultant was completing the application form on behalf of an investor for the purchase of an investment contract in the name of either FIC/AIC, the Principal consultant almost invariably completed the Revenue Canada T 2033 form by recording the name of the transferee as being "Principal Trust" notwithstanding that the RRSP funds were being transferred to either FIC/AIC. If this was the first form that the investor was requested to sign and the investor carefully read this form, the investor would be assured that his or her RRSP was being transferred to Principal Savings and Trust. This practice may have misled investors into not carefully scrutinizing application form before signing the latter form.

Finding of Fact:

The business practice described in Part 13.1(d) of this Report caused investors to be misled or deceived with respect to the the identity of the company to which their RRSP plans were being transferred.

13.2: Displaying Signs Referring to Maximum CDIC Coverage as Being $20,000

Displaying signs which referred to the maximum CDIC coverage as being $20,000 to remain public view after the maximum CDIC coverage had been raised to $60,000.

Eileen Wershler, Consumer Law Investigator of the Ministry of Labour and Consumer Services, Vancouver, reported that on July 8, 1987, she attended the location of Principal Savings and Trust Company at 110 - 625 Howe Street, Vancouver, B.C., and observed a sign displayed on the premises indicating that CDIC maximum insurance for each person was $20,000.

Displaying a sign which referred to the maximum CDIC insurance coverage as being $20,000 after the maximum CDIC insurance coverage had been raised to $60,000 may have discouraged some investors from placing their funds in a CDIC insured term deposit certificate when the investor planned to invest more than $20,000.

13.3: Roll-Over of Investments from Principal Savings and Trust Company to FIC/AIC

A significant number of investors who initially placed their funds with Principal Savings and Trust Company have alleged that upon the maturity of their initial investment, these funds were roll-over or transferred to either FIC/AIC without proper authorization from the investor. These investors may be divided into two categories.

(a) Investors who Allege that the Funds were Rolled-Over Without any Authorization

Some investors who had initially purchased a Principal Savings and Trust Company term deposit certificate allege that upon the maturity of their investment, the funds were rolled over into a FIC/AIC investment contract and that this was done without any authorization whatsoever by the respective investors.

To the extent that Principal Savings and Trust Company permitted the funds to be transferred without the authorization of the investor, Principal Savings and Trust Company would be liable to the investor.

(b) Investors who Allege that the Funds were Rolled-Over Without any written Authorization

Some investors who had initially purchased a Principal Savings and Trust Company term deposit certificate allege that upon the maturity of their investment, the funds were rolled over into a FIC/AIC investment contract without any written authorization by the respective investors. The investors in this category deny that they signed any forms authorizing the roll-over or transfer of funds to FIC/AIC. They do acknowledge that they made have had a telephone conversation with a Principal consultant at the time when the investment with Principal Savings and Trust Company matured but their understanding of that conversation was that the investment would be renewed with Principal Savings and Trust Company. The application forms which were used to effect these transfers are part of the business records of FIC/AIC which are under the control of Coopers & Lybrand Ltd. An investor who wishes to obtain a copy of the form may do so by writing to Coopers & Lybrand Ltd.

The circumstances described in the two above mentioned categories may, in large part, be attributable to the practice of Principal Consultants Ltd. permitting some of their consultants to roll-over investments without a written authorization from the investor and the practice of Principal Savings and Trust Company in accepting instructions to transfer funds without the investor's or depositor's signed authorization.

In the first category, the possibility exists that an unscrupulous Principal consultant rolled over the investment from Principal Savings and Trust Company to either FIC/AIC without ever consulting the investor. The Principal consultant could do this by simply completing an application to purchase an either a FIC/AIC investment contract from the proceeds of the maturing investment and by placing the "telephone privileges" stamp and the consultant's signature in the space provided for the signature of the investor. If an investor could prove these facts, the investor would likely succeed in an action against the Principal consultant to recover the financial loss suffered by the investor. The liability of Principal Consultants Ltd. would depend upon several factors including whether a court would make a finding that the Principal consultant was acting within the scope of his employment in conducting business in a manner which was clearly outside the company's stated policies. A defence to any action brought by an investor against either Principal Consultants Ltd. or Principal Savings and Trust Company would be that the investor is estopped from complaining about the roll-over or transfer because every investor received a monthly statement which clearly recorded the fact that the transfer had been made. These monthly statements clearly stated that any discrepancy was to be reported to Principal Group Ltd.

Investors who fall within the second category, face an additional difficulty. In addition to overcoming the defences discussed in the previous paragraph, they would have to prove the extent of the authority that was conferred on the Principal consultant during the telephone conversation. In any litigation commenced by an investor to recover his or her loss, it would likely come down to a contest of credibility between the investor and the consultant.

14.0: THE INVESTMENT CONTRACT ACT

First Investors Corporation Ltd. and Associated Investors of Canada Ltd. were registered in British Columbia under the Investment Contract Act, R.S.B.C. 1979, c. 207. This statute was first enacted in 1962. Although there have been a few amendments to the legislation during the intervening years, the basic provisions have remained virtually unchanged for the past 25 years. Pursuant to this Act, a company (called an "issuer" in the Act), which proposes to issue and sell investment contracts in British Columbia, must apply to the Superintendent of Brokers for registration. The Act also imposes certain filing requirements on an issuer and contains provisions for the registration of salesmen of investment contracts.

The terms of reference for this Inquiry do not explicitly provide for an examination of the application of the Investment Contract Act. Nevertheless, in order to ascertain whether and to what extent FIC/AIC may have made representations which were misleading or deceptive, I found it necessary to conduct a cursory examination of the registration process and the documents which had been filed with the Superintendent of Brokers by FIC/AIC during the last few years. During the Public Hearings and meetings with investors, it became apparent that there was a good deal of misunderstanding by members of the public about the requirements of this statute, and the role and function of the Superintendent of Brokers under this legislation. In part, the Principal Group of companies and some of the Principal consultants may have contributed to the misunderstanding of some investors.

Section 4 of the Act provides that no person shall issue or sell an investment contract in British Columbia unless the person or company is registered as an issuer pursuant to the Act. Section 5 provides that no corporation shall be registered as an issuer unless several requirements are satisfied. A full text of section 5 is quoted below.

5. (1) No corporation shall be registered as an issuer unless
   - (a) it has filed with the superintendent a certified or photostatic copy of its instrument of incorporation, a certified list of the names and addresses of its executive officers, a certified copy of its balance sheet t the close of its last completed fiscal year, its auditor's report on the balance sheet and a copy of each form of investment contract proposed to be issued by it for sale in the Province;

> (b) at least $100,000 of it authorized capital stock has been subscribed and paid in, in cash, and the aggregate of its unimpaired paid in capital and its surplus is at least $200,000; and
>
> (c) arrangements satisfactory to the superintendent have been made to deposit, with a savings institution, or other depositary in Canada, qualified assets valued under sections 22 and 23 at not less at any time than the amount for which the corporation, under its investment contracts, is liable at that time to pay in cash to the holders of outstanding contracts, or at a smaller amount believed by the superintendent appropriate.
>
> (2) A further deposit is not required where the corporation's deposit under subsection (1)(c) is outside the Province but in Canada.

Where requirements of section 5 are met, and the requisite fee has been paid, section 9 of the Act provides that the Superintendent "shall grant registration or renewal of registration" to an issuer where the applicant is suitable for registration, and the sale of investment contracts issued by it would not tend to be a fraud on buyers of the contracts. If the Superintendent does not have any evidence upon which to conclude that the applicant is unsuitable, or evidence which indicates that the investment contracts would tend to be a fraud on buyers of the contracts, section 9 of the Act requires that the Superintendent grant the registration or renewal.

Every registration or renewal of a registration lapses on the last day of March, and section 8 of the Act provides that an issuer shall, before March 22, apply for a renewal of registration in the form and with the fee prescribed. The Superintendent has adopted a "Uniform Application For Renewal of License or Registration" which is used for several different types of financial institutions which come under the jurisdiction of the Superintendent of Brokers. The top half of this "Uniform" application form requires the applicant to verify certain basic information such as name and address, or indicate that there has been a change in this information since the date of the last application and provide details of any such changes. The lower part of the "Uniform" application requires the applicant to answer more substantive questions concerning any legal proceedings which involve the company, and any changes in the senior management of the company.

In the case of both FIC/AIC, the last Application for Renewal of their respective registrations was dated February 24, 1987, and both were signed by Kenneth N. Marlin as president of the companies. Copies of the applications for renewal of the registration by both FIC/AIC, for the years 1985, 1986 and 1987, are included in Appendix 14 of this Report. With respect to the 1987 application for renewal of its registration by both FIC/AIC, it may be observed that the form indicates that there had been a change since the previous year's application in both the business telephone number and the address for service in B.C. The latter change appears to merely reflect a change of address by the company's solicitors.

In the case of AIC, the company indicated on its 1987 application for renewal that the company was the subject of pending legal proceedings. A description of three legal proceedings, wherein the company is named as a defendant, was attached to the application and this description refers to previous renewal applications where these legal proceedings were described more fully. The attachments to the 1985 application provide further details with respect to these legal proceedings. These attachments are also included in Appendix 14 of this Report. AIC also indicated on its 1987 application that there had been a change in the directors of the Company, and a list of the directors was attached to the application form.

In the case of FIC, the responses on the application for renewal of its registration were similar to those of AIC. The legal proceedings against FIC were the same as those against AIC, except that there was one additional legal proceeding against FIC. The details with respect to this latter proceeding may be found in the attachment to the 1986 application. FIC also indicated on its 1987 application that there had been a change in the directors of the Company, and a list of directors was attached to the application form. This list differs from that filed in the office of the Registrar of Companies in that it includes the name of Eric Espenberg as the Treasurer of the Company, whereas his name does not appear on the records of the Registrar of Companies.

The nature of the legal proceedings described in the attachments to the applications would not be unusual for companies of this size and nature. With the exception of the action brought by 79525 Holdings Ltd., the amounts claimed are relatively small and none of the actions appear to have proceeded to a judgment against the companies. The action brought by 79525 Holdings Ltd. does not appear to relate to the purchase of an investment contract by an investor, but rather to the sale of a large commercial asset by AIC. These legal proceedings may have more significance, in the light of current knowledge of the companies' business practices, than they would have had at the time when these applications were filed.

Section 17 of the Investment Contract Act requires each registered company to file the types of financial statements specified by the section, with the Superintendent of Brokers, within the times specified by the section. It may be observed that the Act does not impose any duty upon the Superintendent to verify the financial statements that are filed by a company pursuant to section 17. As a matter of practice, the Superintendent, or a member of the Superintendent's staff, does examine the financial statements and the auditor's report on the statement in order to ascertain whether there are any irregularities. If any irregularities are observed, the Superintendent has the power, pursuant to section 19 of the Act, to inspect the records of the issuer. The only sanctions provided by the Act, for a failure to file the required financial statements on time, are the commencement of a prosecution pursuant to section 26 (2) which, upon conviction, would result in a maximum fine of $500, or the suspension of the company's registration pursuant to section 13 of the Act.

Recent filings by both FIC/AIC under section 17 of the Act have been examined. In particular, I have examined the audited financial statements, prepared for each company by Deloitte Haskins & Sells as at December 31, 1985. These were the last audited statements of these companies. These financial statements were reproduced in the Plans of Arrangement which were sent to all investors by Coopers & Lybrand Ltd. A copy of these financial statements is included in Appendix 14 of this Report. I have also examined certain correspondence between the office of the Superintendent of Brokers and these companies with respect to these financial statements. It is apparent from the correspondence that the Superintendent's office, after examining these statements, had a number of questions and concerns about them. These are expressed in a letter dated June 16, 1986, from E.F. Smith, C.A., the Acting Deputy Superintendent of Brokers, addressed to Mr. Ken Marlin, wherein the Acting Superintendent demanded that certain information be provided by FIC/AIC before the registration of these companies would be renewed. A copy of this letter is included in Appendix 14 of this Report. A response to this request was received by a letter dated June 20, 1986, on Principal Group Ltd. letterhead from S.W. Martin, Vice-President - Finance. A copy of this letter is included in Appendix 14 of this Report. After reviewing the information provided by Mr. Johnson, the Superintendent of Brokers and Real Estate, Michael C. Ross, C.A., by a letter dated July 4, 1986, made certain demands upon FIC/AIC as preconditions for the continued registration of FIC/AIC under the Investment Contract Act. A copy of this letter is included in Appendix 14 of this Report. One of the conditions which was contained in that letter is quoted below:

> "1. Insertion of qualified assets into AIC of $1,683,000 and FIC of $9,567,649."

By a letter dated August 27, 1986, addressed to the Superintendent of Brokers, K. Marlin, as President of FIC/AIC, confirmed:

> "Principal Group Ltd. (PGL) has inserted qualified assets into AIC in the amount of $1,683,000 and into FIC the amount of $9,567,649 pursuant to your request of July 4, 1986. The qualified assets held by each of AIC and FIC are represented by secured promissory notes receivable from PGL. These notes are collaterally secured by the equity in certain mutual fund holdings of PGL. The offset to the note receivable is a subordinated note payable to PGL. Copies of all notes are enclosed for your review, as well as the agreements between PGL, FIC and AIC and a list of the collateral assigned as security."

A copy of this letter is included in Appendix 14 of this Report. Upon receipt of this letter, the registration of FIC and AIC was renewed for 1986-87.

Two sections of the Act deal with the question of valuation of assets. Section 5 (c) of the Act provides that qualified assets are to be valued under sections 22 an 23 of the Act. With respect to mortgages, section 22 (b) provides that an investment contract company may value mortgages:

> "...in the amount of the balance of the principal sum secured together with unpaid interest accrued;"

Mortgages made up a significant proportion of the investment portfolios of FIC/AIC. A substantial percentage of these mortgages had been non-performing for a considerable period of time, in the sense that payments were not being made by the mortgagors. Interest was accruing on these non-performing mortgages and FIC/AIC were entitled, pursuant to section 22, to show this accrued interest as part of the qualified assets of the company, notwithstanding that the underlying value of the land against which the mortgage was registered may have declined substantially due to the depressed real estate market in the Province of Alberta.

Three sections of the Act deal with the filing and powers of review with respect to various types of application forms, investment contracts and promotional literature that may used by an investment contract company. This is one of the topics upon which there appears to be considerable misunderstanding among members of the public with respect to the role and function of the Superintendent of Brokers.

Section 5 of the Act provides that one of the prerequisites for registration of an issuer is that the issuer must file "a copy of each form of investment contract proposed to be issued by it for sale in the Province". Section 3 (1) of the Act also requires a form of any investment contract shall be filed with the Superintendent before the company issues the contract in that form; however, section 3 (2) provides that:

> "(2) The superintendent shall accept a form tendered unless the sale of an investment contract in that form would tend to be a fraud on the buyer."

There is no express requirement that a form of investment contract which is "filed" with the Superintendent by an investment contract company must be "approved" by the Superintendent before it is used by the investment contract company; however, if, pursuant to section 9 of the Act, the Superintendent concluded that the form of contract would tend to be a fraud on buyers of the contracts, this could used by the Superintendent as a ground for refusing to register the issuer. FIC and AIC did file forms of investment contracts with the Superintendent, in accordance with sections 3 and 5 of the Act, and the Superintendent did not take any objection to these forms. An example of a form of formal investment contract is included in Appendix 14 of this Report. The formal investment contract is the document which is issued by the company after it accepts the investors application to purchase. It is an important document; however, it has not been the source of the problems which have surfaced in this Inquiry. The more important document is the "Application" to purchase the investment contract. It is the latter document which is signed by the investor and which commits the investor to purchase the investment contract.

Section 20 of the Act is the only section which mentions the "application form" as well as other types of documents. This section merely provides that the superintendent may require an issuer or salesman to submit the material listed in the section to the Superintendent for review. Section 20 provides:

> "20. The superintendent may at any time require an issuer or salesman to submit for review circulars, pamphlets, specimen contracts, application forms or other documents used by the issuer or salesman in selling investment contracts."

Section 20 does not give the Superintendent power to forbid the use of any of these documents which the Superintendent may conclude are misleading, or which may tend to mislead investors. The power of the Superintendent to suspend or cancel a company's registration may only be exercised on a ground which would justify refusal of registration. A company is not required to file application forms, circulars and pamphlets in order to obtain registration.

The most important document referred to in section 20 is the application form, and there are recommendations later in this report concerning the design and content of the application form. With respect to the other types of documents which are described in section 20, it would not be practical to require that the Superintendent, or other regulatory official, approve every circular, pamphlet and brochure before it is printed and distributed by a financial institution. It would be practical to require investment contract companies to file and obtain the approval of a form of prospectus which potential investors would be entitled to obtain before investing their funds with the company. The recommendations this Report will give further consideration to this issue.

The type of registration and filing system provided by the Investment Contract Act may be described as a passive depository system. The Act does little more than provide for the maintenance of certain records. The superintendent's powers are limited, and many are discretionary powers which the Superintendent is not required to exercise.

Recommendations for reform of this legislation are contained in Part 17.2 of this Report.

15.0: CURRENT STATUS OF LEGAL PROCEEDINGS

Legal proceedings have been commenced or undertaken with respect to each of the companies named in the Minister's Order. The status of these proceedings, as of October 9, 1987, is described below.

15.1: FIC/AIC - Proceedings under the Companies Creditors" Arrangement Act

References were made in Parts 10.2 and 10.3 of this Report to the proceedings taken in the Alberta Court of Queen's Bench which had the effect of placing FIC/AIC under the management of Coopers & Lybrand pursuant to the Companies Creditors' Arrangement Act. Several of the developments which have occurred as part of these proceedings should be mentioned.

(a) Interim Distribution to Investment Contract Holders

The Alberta Court of Queen's Bench authorized Coopers & Lybrand to make an interim distribution to the holders of both FIC/AIC investment contracts of 30 cents for each dollar of an investor's claim. The claim of each investor holders was calculated on the basis of the principal plus interest calculated to June 30, 1987. This distribution was made to investors on September 15, 1987, subject to the exceptions described below.

The interim distribution was not paid to those investors who had borrowed money from any of the Principal Group of companies and who had signed a document granting security for the loan over of their FIC/AIC investment contract. The existence of these loans and security agreements gives rise to several legal questions pertaining to the ability to set-off one claim against another. The interim distribution of investors in this category will be held until these legal issues have been resolved. These legal issues have been referred to the Alberta Court of Queen's Bench for determination.

Investors who had their money in RRSP plans with FIC/AIC were given the opportunity to transfer their interim distribution to another RRSP plan and thereby avoid the adverse income tax consequences which would result from a payment in cash to the investor. Where investors, who have RRSP plans, have neither returned the RRSP transfer form to Coopers & Lybrand nor requested the payment of their interim distribution in cash, Coopers & Lybrand are holding their interim distribution pending the receipt of written instructions from the investor.

(b) Plans of Arrangement

A Plan of Arrangement for the distribution of the assets of both FIC and AIC was sent to each investment contract holder. The Plans of Arrangement for both FIC/AIC have been approved by the investment contract holders in accordance with the terms of the Plan and the Act. The Plans of Arrangement still require the approval of the Alberta Court of Queen's Bench.

(c) Investment Contract Holders Committee

The Court appointed an Investment Contract Holders Committee to oversee the management of assets of FIC/AIC by Coopers & Lybrand. This Committee performs the important function of ensuring that the sale of the assets of FIC/AIC and the distribution of the proceeds to the investors are handled in the best interest of the investors.

The initial Order of the Court provided for a five member Committee. The Commission solicited names of potential nominees for membership on the Committee from each of the regional groups of investors in the Province of British Columbia. The names of these nominees were forwarded to legal counsel in Edmonton who was retained by the Province of British Columbia. The legal counsel appeared before the Court in Alberta and submitted that there should be representation on the Committee from British Columbia and that there were well qualified persons from British Columbia who were willing to serve on the Committee. Initially, the Court only filled three of the positions on the Committee. A further application was made by legal counsel retained by the Province of British Columbia to persuade the Court to add an investor from British Columbia to the Committee. The Court appointed an investor from Saskatchewan to the Committee but one of the Alberta members has since resigned. The Committee's current membership consists of two investors, Mr. Kenneth Wark of Edmonton and Mr. Conrad McCoy of Saskatoon, and the Honourable V.H. Milvain, Q.C., Chairman.

(d) Appointment of Special Counsel

The Court appointed a Special Counsel to represent the investors in British Columbia and northern Alberta. He is Mr. Robert White, Q.C., of the firm of

Lucas, Bishop and Fraser in Edmonton, Alberta. British Columbia investors may contact him by writing to:

Mr. Robert White, Q.C.
Special Counsel
1501 Toronto-Dominion Tower
Edmonton Centre
Edmonton, Alberta
T5J 2Z1

The functions of the Special Counsel include:

(i) representing investors collectively with respect to all proceedings relating to the Plans of Arrangement for FIC/AIC; and

(ii) acting on behalf of investors in relation to the Inquiry, in the Province of Alberta, being conducted by William Code, Q.C.

The Special Counsel may not act on behalf of an individual investor. Nevertheless, the appointment of the Special Counsel will greatly assist British Columbia investors with various proceedings in relation to FIC/AIC. Lawyers associated with Mr. White have attended a number of public meetings in British Columbia including meetings in Vancouver, Kelowna, Kamloops, Penticton and Victoria.

15.2: British Columbia Supreme Court Proceedings

On August 10, 1987, a writ of summons was filed in British Columbia Supreme Court by the Director of Trade Practices. The defendants named in that writ of summons were Principal Group Ltd., Principal Savings and Trust Company and Principal Consultants Ltd. The claim asserted in the writ of summons is against the Defendants and each of them pursuant to section 18 of the Trade Practice Act, R.S.B.C. 1979 c. 406 for:

"(a) a declaration that the Defendants engaged in misleading deceptive practices in respect of consumer transactions, namely the purchase of investment contracts from First Investors Corporation Ltd. and Associated Investors of Canada Ltd. between 1975 and 1987;

(b) an injunction to restrain the Defendants from further deceptive practices;

(c) damages for losses occasioned by such practices;

(d) a declaration that the Defendants and each of them are suppliers within the meaning of the Trade Practice Act;

(e) other relief as may be set out in a Statement of Claim."

The shares of Principal Consultants Ltd. are owned by Principal Group Ltd. which is in bankruptcy. The Trustee in Bankruptcy of Principal Group Ltd. has advised me that in his opinion Principal Consultants Ltd. is insolvent in the sense that its liabilities exceed the value of its assets. No proceedings have been taken to place Principal Consultants into bankruptcy; however, the Trustee in Bankruptcy of Principal Group Ltd. has advised me that he will likely take action to place Principal Consultants Ltd. into bankruptcy.

15.3: "Freeze Orders" pursuant to the Trade Practice Act

On August 10, 1987, the Director of Trade Practices made two orders pursuant to the authority contained in section 14 of the Trade Practice Act. One order was directed to Principal Group Ltd. and Principal Consultants Ltd. The other order was directed to Principal Savings and Trust Company. Both of these orders directed the companies named therein to hold any assets, trust funds or other property in possession control, in trust for an interim receiver. The order in relation to Principal Savings and Trust Company has been temporarily lifted until the end of October, 1987, in order to permit Metropolitan Trust to take over the former branches of Principal Savings and Trust Company and thereby permit the latter's depositors to gain access to their funds through an arrangement between CDIC and Metropolitan Trust.

15.4: Principal Group Ltd. Bankruptcy

On August 10, 1987, a Writ of Summons was filed in the British Columbia Supreme Court by the British Columbia Director of Trade Practices naming Principal Group Ltd. as a defendant together with others. The claims made in the writ of summons were made by the Director on behalf of all investors in British Columbia who were misled or deceived by Principal Group Ltd., and the writ claims damages against Principal Group Ltd.

On the same date, Principal Group Ltd. made an assignment in bankruptcy pursuant to the Bankruptcy Act, R.S.C., 1970, chap. B-3. The assignment was filed with the Official Receiver in Edmonton, Alberta. The Official

Receiver appointed Mr. J. Stephens Allan of the firm of Collins Barrow Limited, 800 Gulf Canada Square, 401-9th Ave. S.W. Calgary, Alberta, as the Trustee in Bankruptcy.

Any person who claims to be a creditor of the Principal Group Ltd. must file a Proof of Claim with the Trustee in Bankruptcy. The Trustee is required by the Bankruptcy Act to mail a Proof of Claim form to all of the creditors of which the Trustee has notice.

The holders of promissory notes issued by Principal Group Ltd. are clearly creditors of the bankrupt company and they must file a Proof of Claim with the Trustee. The Trustee is in possession of the records of Principal Group Ltd., and he has advised me that he has sent Proof of Claim forms to the holders of promissory notes which are shown on the records of the Company.

The acceptance of an assignment in bankruptcy by the Official Receiver and the appointment of a Trustee in Bankruptcy has the legal effect of suspending all other legal proceedings against the bankruptcy except with the permission of the Bankruptcy Court. Section 49 (1) of the Bankruptcy Act provides:

> "49. (1) ... upon the bankruptcy of any debtor, no creditor with a claim provable in bankruptcy shall have any remedy against the debtor or his property or shall commence or continue any action, execution or other proceedings for the recovery of a claim provable in bankruptcy until the trustee has been discharged ... unless with the leave of the court and on such terms as the court may impose."

The effect of section 49 is that the Director of Trade Practices cannot proceed with his action against Principal Group Ltd. in the Supreme Court of British Columbia in the absence of the permission of the court sitting in Bankruptcy. The courts are generally reluctant to grant leave or permission to proceed with a independent civil action against a bankrupt unless there is evidence that the claim in the civil action cannot be effectively pursued by means of the procedures set forth in the Bankruptcy Act.

The Preliminary Statement of Affairs which was filed at the time of the assignment in bankruptcy listed the assets of the company at a value of $85,303,000 and the liabilities of the company at $94,667,000. The liabilities include the amounts owing to the holders of promissory notes which were sold by the company. A copy of the Preliminary Statement of Affairs is included in Appendix 15.3 of this Report. There are somewhat fewer than two hundred promissory note holders who are resident in British Columbia.

The Trustee in Bankruptcy convened a First Meeting of Creditors in Edmonton in early October, 1987. At that meeting, the appointment of the Trustee was confirmed and five inspectors were appointed pursuant to the Bankruptcy Act. The Trustee does not propose to make an interim distribution to the promissory note holders or other creditors until the validity of contingent claims by individual FIC/AIC investors has been resolved. Discussions have begun between the Trustee in Bankruptcy of Principal Group Ltd. and Coopers & Lybrand Ltd., as the manager of FIC/AIC, for the purpose of ascertaining whether a proposal for the settlement of the contingent claims which FIC/AIC investors may have against Principal Group Ltd. These discussions are being undertaken with the concurrence of the Investment Contract Holders Committee and would require the approval of the investors.

15.5: Principal Savings and Trust Company Liquidation

In Part 10.4 of this Report, reference was made to the fact that upon the closure of Principal Savings and Trust Company, the Canada Deposit Insurance Corporation obtained an Order that the Company be wound-up pursuant to the Winding-Up Act, R.S.C. 1970, c. W-10, and Bruce I. Robertson and Associates Ltd. was appointed as the Provisional Liquidator of the Company.

In the above mentioned proceedings, an affidavit by J.P. Sabourin, the Executive Vice-President and Chief Operating Officer of CDIC, was filed. In the affidavit, which was sworn on the 13th day of August, 1987, he stated:

> "(a) Based on PST's June 30th, 1987 financial statements provided to CDIC, PST held approximately $135,000,000.00 on deposit from the public. CDIC has been informed by BIRA and verily believes that a total of approximately $125,000,000.00 of deposits are insured by CDIC to the extent of a maximum of $60,000 in respect of each depositor."

There will be a shortfall of assets in relation to liabilities which will probably exceed $35 million.

This Order made by the Alberta Court of Queen's Bench in the proceedings under the Winding-Up Act provided that no other legal action shall be proceeded with against Principal Savings and Trust Company except with leave of the Alberta Court of Queen's Bench. This provision in the order means that the British Columbia Director of Trade Practices cannot proceed with his action against Principal Savings and Trust Company without the permission of the Court.

Metropolitan Life Insurance Company through its subsiduary companies acquired certain assets of Principal Savings and Trust Company as well as other assets of Principal Group Ltd. under the terms of a Court approved purchase from the Trustee in Bankruptcy of Principal Group Ltd. Metropolitan has reopened the former Principal Savings and Trust Company branches under the name of Metropolitan Trust. Metropolitan also made an arrangement with Canada Deposit Insurance Corporation whereby the CDIC insured deposits and term deposit certificates of Principal Savings and Trust Company would be honoured by Metropolitan Trust and the CDIC insured RRSP contracts of Principal Savings and Trust Company would be transferred to Metropolitan.

The Liquidator will be publishing an advertisement in all cities where Principal Savings and Trust Company had branch for the purpose of notifying potential claimants who wish to make a claim in the liquidation proceedings. Claimants will be required to file a proof of claim form. The date by which claims must be filed has not yet been set by the court.

15.6: Alberta Inquiry

Mr. William Code, Q.C., of Calgary, has been appointed by the Alberta Court of Queen's Bench as an "Inspector" to conduct an inquiry in Alberta with respect to FIC/AIC. His terms of reference include the powers specified in the paragraph from the Order of the Court dated August 13, 1987, which is quoted below:

> "The Inspector may conduct such hearings as he requires from time to time and shall have the power to summon and compel attendance of witnesses and, without restricting the generality of the foregoing, shall have the power to summon Ministers of the Crown in Right of the Province of Alberta and their deputies and employees of the Province of Alberta duces tecum or otherwise require production of documents, administer oaths and may seek advice and directions with respect to such proceeding from time to time as required."

In Part 8 of this Report, I observed that many of the witnesses and much of the documentary evidence pertaining to the named companies is located in Alberta. This evidence may be beyond the reach of a Commission of Inquiry appointed in British Columbia for the reasons set forth in Part 8 of this Report. I have met with Mr. Code and I anticipate that most, if not all, of this evidence will be brought before Mr. Code as part of his Inquiry and it will become part of the public record of that Inquiry. When this evidence becomes available, it should be examined in order to ascertain whether it discloses any legal claims and actions which investors may have.

Mr. Code expects to open the first session of his Inquiry on October 14, 1987.

15.7: Limitation Periods on Legal Actions

Many different limitation periods are imposed by various statutes with respect to the commencement of different types of legal proceedings. These limitation periods set the deadline by which legal proceedings must be commenced. The limitation periods vary depending on a variety of criteria including:

(a) The type of claim that is being made against the defendant in the proceeding,

(b) The category of defendant against whom the claimant seeks to bring an action, and

(c) The knowledge or lack of knowledge which the claimant may have had at various material times.

The uncertainty with respect to the limitation period, or periods, which may apply in relation to the matters which are the subject of this Inquiry is compounded by the fact that different limitations may apply depending upon whether legal action is commenced in the courts of Alberta, or the courts of British Columbia. Certain types of legal proceedings in these matters can only be commenced in the courts of the Province of Alberta. The Special Counsel appointed by the Alberta Court of Queen's Bench to represent British Columbia investors has taken the position that he cannot advise individual investors about their respective individual legal rights. Instead, the Special Counsel has advised investors that they should seek independent legal counsel to advise them with respect to their individual legal rights, and particularly the limitation periods which may apply with respect to the commencement of legal proceedings.

Unfortunately, it is impossible to give any legal advice with respect to the application of limitation periods. Before legal advice can be given with respect to the application of a limitation period, it is necessary to know the specific facts which pertain to the individual investor.

16.0: OTHER LEGAL QUESTIONS

Other legal questions have been raised during the course of the Commission of Inquiry which are not dealt with in this Report. These questions are not within the terms of reference of the Inquiry but a summary of the questions and some brief comments about the questions may assist the investors in their understanding of some of the legal issues surrounding these questions.

16.1: Inter-Corporate Transactions Between Members of the Principal Group of Companies

Many investors have asked about whether legal action may be taken to review and set aside transfers of assets or money by FIC/AIC or Principal Group Ltd. which had the effect of diminishing the assets of these companies which would otherwise have been available to the investors. Coopers & Lybrand as the manager of of FIC/AIC and Mr. J. Stephens Allen as the Trustee in Bankruptcy of Principal Group Ltd. have a responsibility to take whatever action may be necessary on behalf of the investors and creditors of the respective companies to ensure that any transactions which were fraudulent conveyances or fraudulent preferences are reviewed and legal proceedings taken if they are advisable. With respect to FIC/AIC, the Investment Contract Holders Committee will serve to ensure that Coopers & Lybrand continues to vigourously pursue these matters as it has done during the past three months. With respect to Principal Group Ltd., the Inspectors have a responsibility to ensure that the Trustee in Bankruptcy will pursue these matters. There are some transactions where there will be a dispute between FIC/AIC and Principal Group Ltd. In these instances, it may be in the interests of the investors in both of these companies for the Trustee and Coopers & Lybrand to reach an out of court settlement of the respective claims rather than use valuable assets to resolve the dispute in protracted litigation before the courts.

16.2: Canada Deposit Insurance Corporation

Some FIC/AIC investors have raised questions about whether they may be able to successfully assert a claims against CDIC. These questions are beyond my terms of reference; however, a comment on whether any evidence has come before the Commission which may be relevant to these questions, is in order.

The investors who raised these questions fall into several categories. The first category includes those investors who paid money to Principal Savings and Trust Company and the funds were invested in a term deposit certificate or deposit account which was covered by CDIC insurance but the funds were subsequently transferred to a FIC/AIC investment contract without the investor's authorization.

The second category includes those investors whose Principal consultant made a representation to them that a FIC/AIC investment contract or a promissory note with Principal Group Ltd. was insured by CDIC. There is no evidence before the Commission to suggest that the Canada Deposit Insurance Corporation was aware of such representations being made. In the absence of such evidence, Canada Deposit Insurance Corporation could not be held liable for representations made by Principal consultants about CDIC insurance coverage.

The third category includes those investors who may been were misled by signs located on Principal Savings and Trust premises into believing that CDIC only provided insurance coverage on insured accounts up to a maximum of $20,000 when in fact the maximum insurance coverage had been increased to $60,000. There is evidence referred to in Part 13.5 (f) of this Report that Principal Savings and Trust Company continued until July 1987 to permanently display on the window of its Vancouver branch information which stated that the maximum insurance coverage provided by CDIC was limited to $20,000.

The investors in each of the three categories raise both legal and evidentiary questions. These questions are beyond my terms of reference.

16.3: Auditors

Some FIC/AIC investors have raised the question of whether they have any legal claims against the auditors of FIC/AIC. This question is beyond my terms of reference; however, a comment on whether any evidence has come before the Commission, which may be relevant to this question, is in order. Evidence of reliance by an investor upon an audited financial statement at the time when the investment is made is usually a prerequisite to any such claim by an investor. FIC/AIC did not publish or make their audited financial statements to investors and no evidence has come before the Commission that any investor relied upon an audited financial statement of FIC/AIC. Principal Group Ltd. did publish "consolidated" financial statements together with an auditor's report in some of their annual reports and some investors have reported to the Commission that they relied on these document when they made their decision to invest in Principal Group Ltd. These consolidated financial statements do not contain any separate information about the financial affairs of FIC/AIC.

16.4: Government of Alberta

Some investors have raised the question of whether they have any legal claim against the Government of Alberta. This question is beyond my terms of reference. No evidence has become before the Commission which would be relevant to this question.

17.0: RECOMMENDATIONS

On August 10, 1987, I made a several verbal recommendations which were based on the evidence which had been obtained by that date. Those recommendations included a recommendation that the Director of Trade Practices commence legal proceedings on behalf of British Columbia investors pursuant to the Trade Practice Act, R.S.B.C. 1979, c.406, against Principal Savings and Trust Company, Principal Group Ltd., and Principal Consultants Ltd. That report was made verbally because of the need to take immediate action in view of the impending bankruptcy of Principal Group Ltd. Subsequent to making this recommendation, the Director of Trade Practices acted on that day by filing a writ of summons in British Columbia Supreme Court naming these companies as defendants. Orders were also made by the Director, pursuant to section 14 of the Act, to freeze the assets of these companies in British Columbia.

The recommendations in this Report are divided into several categories, namely:

- Legal Proceedings;
- Legislative or Regulatory Changes which should be considered; and
- Evidence - Custody of and Access to Evidence gathered during the Inquiry.

17.1: Legal Proceedings

This Part of the Report includes recommendations with respect to further legal action which may need to be taken with respect to legal proceedings and additional legal action which should be taken.

(a) Legal Proceedings in Relation to FIC/AIC:

Part 15.1 of this Report describes the legal proceedings that have already been taken with respect to FIC/AIC. Whether any further legal action will need to be taken, by or on behalf of British Columbia investors, will primarily depend upon whether the Plan of Arrangement for each of these companies is approved by the Alberta Court of Queen's Bench.

(i) If the Plans of Arrangement are Approved:

If the respective Plans of Arrangement for both FIC/AIC are approved by the Alberta Court of Queen's Bench, the proceedings for the realization upon the assets of these companies and the distribution of the proceeds to the investors should proceed in an orderly manner pursuant to the respective Plans of Arrangement under the Companies Creditors' Arrangement Act. The Special legal Counsel who has been appointed to represent British Columbia investors in relation to proceedings under this Act will continue to be available to represent British Columbia investors in relation to the general administration of the these companies by Coopers & Lybrand including the realization of assets and the distribution of proceeds to investors. The Special Counsel and the Investment Contract Holders Committee should provide more than adequate assurance that the interests of all investors including British Columbia investors are protected.

RECOMMENDATION ONE:

> If the Plans of Arrangement are approved by the Alberta Court of Queen's Bench, it should not be necessary for the British Columbia Director of Trade Practices to take any further legal proceedings with respect to the realization of the assets of FIC/AIC or the distribution of the proceeds of those assets to investors.

Some further legal representation may be required to protect the the interests of British Columbia investors with respect to to the proposal by the Government of Alberta to pay a share of Coopers & Lybrand's fees for the administration and liquidation of the assets of FIC/AIC. In principle, this is a laudable gesture by the Government of Alberta, provided that it benefits all investors regardless of their province of residence. There could not be any objection in law if the Government of Alberta pays a sum of money to Coopers & Lybrand based on the number of investors in Alberta and Coopers & Lybrand add that amount to the proceeds of realization from which Coopers & Lybrand's fees are deducted. Similarly, if Coopers & Lybrand is requested to send an invoice for a certain percentage of its fees directly to the Government of Alberta, no objection could be taken. In either instance, the proceeds remaining for distribution among all investors will be enhanced and there is no derogation from the principle of pro rata distribution among investors regardless of the investor's province of residence. Any derogation from the principle of pro rata distribution would be in violation of the Plans of Arrangement which have been approved by both the investors and the Court. It should be observed that many investors who are currently residing in British Columbia purchased their investments while they were residing in Alberta. It was only after they retired from employment in Alberta that they moved to British Columbia.

RECOMMENDATION TWO:

> If the Province of Alberta purports to pay a share of the fees of Coopers & Lybrand in a manner that has the effect benefiting only those investors residing in Alberta, consideration should be given to making an application to the Alberta Court of Queen's Bench for an order to ensure that all investors are treated on a pro rata basis regardless of their province of residence.

It is unlikely that the value of the assets owned by either of these companies will be sufficient to pay the investment contract holders in full. Whether the investors are able to recover any shortfall will depend on whether these investors are able to successfully assert claims against others.

(i) If the Plans of Arrangement is Not Approved:

If the Plan of Arrangement with respect to either FIC/AIC is not approved by the Alberta Court of Queen's Bench, the proceedings in relation to that company under the Companies Creditors' Arrangement Act will likely be terminated. This would also have the effect of terminating the appointment of the Special Counsel who has been appointed to represent British Columbia investors. Claims of investors would have to be dealt with by another form of legal proceeding. In all likelihood, a Petition in Bankruptcy would be permitted to proceed and a Trustee in Bankruptcy would be appointed.

If either FIC/AIC are placed in bankruptcy, the Trustee in Bankruptcy would probably be required to follow the procedures set forth in the Bankruptcy Act as if the proceedings under the Companies Creditors' Arrangement Act had never taken place. Therefore, the Trustee would send a Proof of Claim form to each holder of an FIC/AIC investment contract. In order to participate in the distribution of proceeds realized from the sale of assets of these companies in bankruptcy proceedings, the holder of each investment contract would have to complete and file a Proof of Claim form with the Trustee in Bankruptcy. This process will likely be confusing to many investors particularly when they have already received a "Notice of Validated Claim" from Coopers & Lybrand in the Companies Creditors' Arrangement Act proceedings. It is unlikely the Bankruptcy Court would appoint a Special Counsel to assist the investors with the filing of Proof of Claim forms and the completion of proxies for any meetings of creditors. Therefore, in the event that either of the Plans of Arrangement is not approved by the

Court, a process should be established in British Columbia to assist investors with these tasks.

RECOMMENDATION THREE:

> In the event that the Plan of Arrangement for either FIC/AIC is not approved, and either or both of FIC/AIC are put into bankruptcy, the British Columbia Director of Trade Practices should be directed to assist the holders of FIC/AIC investment contracts with the completion and filing of Proofs of Claim and proxies with any Trustee in Bankruptcy who may be appointed with respect to either or both of FIC/AIC.

(b) Proceedings against Principal Group Ltd.

Part 15.4 of this Report contains a description of the bankruptcy proceedings in relation to Principal Group Ltd. which are underway in Alberta.

There are at least two categories of investors who may file claims in bankruptcy against this company.

(i) Investors holding Promissory Notes issued by Principal Group Ltd.

Investors who purchased Principal Group promissory notes are clearly creditors of Principal Group Ltd. They must file a Proof of Claim form in order to be entitled to share in the distributions of the proceeds from sale of the assets of Principal Group Ltd. The holders of promissory notes should already have received a Proof of Claim form from the Trustee in Bankruptcy. If they have not received a Proof of Claim form, they should immediately obtain, complete and return a Proof of Claim to the Trustee.

(ii) Investors holding FIC/AIC investment contracts

Some but not all holders of FIC/AIC investment contracts may have a claim against Principal Group Ltd. Those FIC/AIC investors who may have a claim against Principal Group Ltd. are those who relied in either making or renewing their investment upon a representation made by Principal Group Ltd. which was deceptive or misleading. The representation may have been made by Principal Group Ltd. operating under the name and style of "Principal", "the Principal Group" or "the Principal Group of Companies". The representation may have been made in written material published by "Principal", "the Principal Group", "the Principal Group of Companies" or made orally by officers, employees or agents of Principal Group Ltd. The representation may have been made about the nature of the insurance or guarantee relating to the investment, characteristics of the investment including the investment portfolio of FIC/AIC or other matters which were material to the investor's decision. This above description of the representations which may have deceived or misled an investor does not purport to be exhaustive.

The types of claims described in the preceding paragraphs were included within the claims made by the Director of Trade Practices in the writ of summons filed in the Supreme Court of British Columbia on August 10, 1987. However, for the reasons mentioned in Part 15.4, all court actions against Principal Group Ltd. are stayed or suspended unless permission is obtained from the court to proceed with the court action. In these circumstances, there appear to be two alternative methods by which claims against Principal Group Ltd. may be asserted by or on behalf of those who hold investment contracts with FIC/AIC. One alternative would be for the Director of Trade Practices to apply to the court for permission to continue his action against Principal Group Ltd. on behalf of British Columbia investors. This alternative has several impediments. First, the courts are usually loath to grant permission to continue an action against a bankrupt. Second, the Director's action is a "representative action" on behalf of all British Columbia investors who have been misled or deceived. If permission were granted by the court, the Director, in order to recover an order for monetary compensation, would have to establish the individual claims of each investor in a trial. This would likely require calling evidence to establish the claims and damages of each individual investor on whose behalf damages are being sought. This alternative has several novel aspects which would require careful consideration by legal counsel before proceeding. The uncertainties with respect to this alternative render it less attractive than the alternative described in the next paragraph.

Another alternative method for FIC/AIC investment contract holder to assert a claim is to obtain and file Proof of Claim form with the Trustee in Bankruptcy of Principal Group Ltd., Mr. J. Stephens Allan. Some FIC/AIC investors may not realize they may have a claim against Principal Group Ltd., in bankruptcy. If they do realize they have a claim they may not be familiar with the procedure for asserting the claim. Therefore, some form of process should be established in British Columbia to provide investors with Proof of Claim forms and information with respect to where the claims should be sent. Such action is necessary because otherwise British Columbia investors may be lulled into not filing claims in the belief they can rely on the legal action taken by Director against Principal Group Ltd. The availability of forms and information may be brought to the attention of investors in the form of a public announcement and by means of communications directed to the local and regional groups of "Principal" investors in British Columbia.

Whatever success is achieved by or on behalf of FIC/AIC investors in proving claims against Principal Group Ltd., will have the effect of reducing the financial return to the holders of Principal Group Ltd. promissory notes. If the Province provides active assistance to FIC/AIC investors, the Province would be assisting one group of investors (FIC/AIC investors) whose success would be detrimental to another group investors (Principal Group Ltd. promissory note holders). The most that the Province of British Columbia should do in relation to claims by FIC/AIC investors against Principal Group Ltd. is to provide forms and information about the procedure for filing claims and appeals and to provide access to evidence which may be in the possession of the Director of Trade Practices. If the Province were to take a more active role assisting FIC/AIC investors with respect to claims against Principal Group Ltd., the Province would not be acting in an even-handed manner between the two groups of investors.

RECOMMENDATION FOUR:

(A) The British Columbia Director of Trade Practices should make some form of public announcement to notify FIC/AIC investors of their right to file a claim in bankruptcy against Principal Group Ltd.

(B) The offices of the British Columbia Director of Trade Practices should serve as distribution points to provide FIC/AIC investors with Proof of Claim forms and provide information with respect to where the Proof of Claims should be sent. The Director should neither assume responsibility for advising investors upon whether they have a valid claim nor assist investors in completing or filing Proof of Claim forms. If an investor requires assistance with the completion or filing of a Proof of Claim form, the investor should be advised to seek independent legal counsel.

Upon receiving a Proof of Claim, the Trustee must either accept or disallow the claim in whole or in part. In the latter case the Trustee must give the claimant notice of the disallowance and the reasons for the disallowance. The claimant then has 30 days from the mailing of the notice within which to appeal the Trustee's disallowance to the court. If there are a substantial number of such claims filed and the Trustee disallows all or most of them in either in whole or in part, there will be a substantial burden and cost upon these claimants if each investor must pursue an appeal to the court. Although there will undoubtedly be individual aspects to many claims, there may be some common allegations of reliance upon misrepresentations which could be heard together. It would be mutually beneficial if these appellants had a means of ascertaining the identity of other investors whose claims have been disallowed by the Trustee in Bankruptcy. It would not be inconsistent with Government's position of neutrality between groups of investors, if the Director of Trade Practices maintained a registry of investors whose claims have been disallowed by the Trustee and the Director provided other investors with access to this directory.

I have informally asked the Special Counsel, who has been appointed to represent British Columbia investors in FIC/AIC matters, whether he could represent investors in any appeals from a disallowance of claims by the Trustee in Bankruptcy of Principal Group Ltd. Although he did not dismiss the possibility of representing FIC/AIC investors in this matter, this type of representation by the Special Counsel may be outside his terms of reference and may be in contravention of the Court's directive that he must not represent individual investors.

In part 15.4 of the Report, a reference to made to the negotiations which are taking place with the objective of reaching some form of settlement with respect to the individual claims of FIC/AIC investors against Principal Group Ltd. which would avoid the cost requiring individual investors to pursue their claims through to the Court. These negotiations are being undertaken by Coopers & Lybrand and the Trustee in Bankruptcy of Principal Group Ltd. and must be approved by the investors. If these negotiations are successful, the following recommendation will not require implementation.

RECOMMENDATION FIVE:

> The British Columbia Director of Trade Practices should maintain a directory of FIC/AIC investors who advise the Director that their claims in bankruptcy against Principal Group Ltd. have been disallowed by the Trustee in Bankruptcy and the Director should provide other FIC/AIC investors whose claims have been disallowed with access to this directory.

(c) Proceedings against Principal Consultants Ltd.

Legal proceedings have been commenced in British Columbia against Principal Consultants Ltd. by the Director of Trade Practices on behalf of all investors in British Columbia who have been misled or deceived. Many of the Findings contained in Parts 12 and 13 of this Report relate to representations or practices by this company and its consultants, employees and agents which were misleading and deceptive. There is no legal impediment to continuing with these proceedings. The assets which may be available to satisfy any judgment which may be obtained in these proceedings has not been evaluated. The Director of Trade Practices has retained Mr. Donald Farquhar, Q.C., as legal counsel, to take such further proceedings in this legal action as may be advisable.

(d) Claims against Individual Consultants of Principal Consultants Ltd.

There may be circumstances where some investors have a cause of action against a Principal consultant. These may include circumstances where:

(i) The Principal Consultant made representations, and

  (I) the representation was false or misleading;

  (II) the Principal consultant either knew the representations were false or misleading or the Principal consultant made the representations in circumstances where the Principal consultant was wilfully blind to whether the representations were true or false;

  (III) that the representations were material; and

  (IV) that the investor acted on the representation to his or her detriment. there there was no basis upon which the Principal consultant could reasonably have believed the representation to be true.

(ii) The Principal consultant made a negligent misrepresentation to an investor. This may have occurred when the Principal consultant negligently misinterpreted information provided to him or her by the Principal Group of companies and the Principal consultant passed this misinterpretation on to the potential investor.

(iii) The Principal consultant acted contrary to the investor's instructions with respect to the investment.

(iv) The Principal consultant was negligent in providing investment advice or failing to provide investment advice with respect to the investments which the investor made.

Whether an individual investor has a legal claim of action against his or her Principal consultant will depend on the particular circumstances of the relationship between the investor and the sales person, the instructions given to the consultant by the investor and the knowledge of the consultant at the time when the representations were made to the investor. With all of these variables, it would not possible for the Director of Trade Practices to take any representative legal proceeding against individual Principal consultants. Individual investors should consult their own legal counsel if they wish to consider taking legal action against his or her Principal consultant.

In many cases, I am satisfied that the Principal consultants honestly believed representations about the characteristics of the investments which had been provided to them by the Principal Group of companies. This is corroborated in many of the cases by the fact the Principal consultant also invested in these companies or sold these investments to family members.

(e) Claims against Principal Savings and Trust Company

On August 10, 1987, the British Columbia Director of Trade Practices commenced a legal action against Principal Savings and Trust Company by filing a writ of summons in the British Columbia Supreme Court. On August 17, 1987, an Order was made pursuant to the Winding-Up Act, R.S.C. 1970, c. W-10, which directed this company be wound up and that no other legal actions be proceeded with against Principal Savings and Trust Company except by permission of the Court. Consequently, the Director cannot proceed with the writ of summons against this company without the permission of the Court and it is unlikely that the Court would grant permission. The above mentioned Order under the Winding-Up Act also appointed a Liquidator for the company.

FIC/AIC investors and Principal Group Ltd. promissory note holders who may have claims against Principal Savings and Trust Company include:

(i) Investors who have suffered damages as a consequence of misleading or deceptive practices used by Principal Savings and Trust Company; and

(ii) Investors whose investments were transferred or "rolled over" from a Principal Savings and Trust Company account to another Principal Group investment without the authority of the investor as described in Part 13.3 of this Report.

These investors may file a Proof of Claim with the Liquidator of Principal Savings and Trust Company, Bruce I. Robertson and Associates Ltd. when the claim process is announced. Advertisements will appear in newspapers published in those locations where Principal Savings and Trust Company had branches.

Investors who may have a claim against Principal Savings and Trust Company are entitled to file a claim against the Company to share in proceeds of assets of the Company if their claim is proven. The information referred to in Part 15.5 of this Report, indicates that liabilities of this company exceed its assets. CDIC, who has paid the claims of Principal Savings and Trust Company depositors has a claim against the assets of approximately $125 million.

A clear estimate of the shortfall of assets in relations to liabilities cannot be made until all of the claims against the company are known. The shortfall is expected to be in the range of $35 - $40 million. CDIC is one of the major creditors of the company by reason of having assumed the liability of paying the insure depositors.

RECOMMENDATION SIX:

> The offices of the British Columbia Director of Trade Practices should serve as distribution points to provide investors with Proof of Claim forms for claims against Principal Savings and Trust Company and to provide investors with information as to where a Proof of Claim should be sent.

(f) Potential Claims against Officers and Directors of Principal Group companies

Questions have been raised by investors during the course of this Inquiry about the personal liability of the officers or directors of the Principal Group of Companies. In law, there are several bases upon which officers and directors may be held personally liable for actions or omissions on their part. This Report does not purport to contain an exhaustive summary of the law pertaining to personal liability of officers and directors. Some of the bases of personal liability which may be relevant in the context of the circumstances described in this Report are set forth below. In order to establish personal liability of officers or directors, evidence would need to be adduced to prove that an officer or director:

(i) Participated in some manner in the making of representations which were misleading or deceptive. Participation could include:

  (I) That the officer or director provided information or made representations to sales personnel associated with the Principal Group of companies which he knew or should have known was false, misleading or deceptive;

  (II) That the officer or director permitted sales personnel to continue to repeat representations previously made by him after he knew or should have known that the representations were false, misleading or deceptive;

  (III) That the officer or director failed to correct previous information or representations which he had made to sales personnel which may have been true when they were made but which had ceased to be true;

(ii) Permitted sales personnel associated with the Principal Group of companies and particularly with Principal Consultants Ltd. to continue to solicit or accept investments in FIC/AIC after the officer or director knew or should have known that the companies were insolvent.

There is evidence that Mr. Donald M. Cormie made representations to Principal consultants in Vancouver, British Columbia in 1982, with respect to the real estate holdings of the Principal Group of Companies. The first representation is set forth in the following quotation:

> "...two years ago, as you know, we said our time is coming in real estate, you got to get out early because if you don't get out early, you can't get cash. So we sold too soon, all our real estate, but we got cash. We didn't sell anything that wasn't 100% cash. We took no paper.

The second representation is set forth in the following quotation:

> "That is why we got out of real estate two years too soon. We could have made 50% more if we had waited but so what, leave a little profit for the other guy."

These two representations were not restricted in their application to any particular member of the Principal Group of Companies and the Principal consultants who were present could reasonably infer that all of the Principal Group of companies had sold their real estate holdings for cash.

The information contained in the financial records of FIC/AIC indicates that a substantial proportion of the investments held by these two companies, throughout the 1980s, has been in either mortgages or real estate.

This evidence is sufficient to warrant the Director of Trade Practices commencing legal proceedings against Donald M. Cormie under the Trade Practice Act.

RECOMMENDATION SEVEN:

> The Director of Trade Practices should add Donald M. Cormie as a defendant in the legal proceedings commenced by the Director on behalf of British Columbia investors, pursuant to the Trade Practice Act, or take such alternative proceedings as the Director's legal counsel may advise.

17.2: Recommendations Pertaining to Legislative or Regulatory Changes

One of terms of reference in the Minister's Order is to make "recommendations". I have interpreted this to include recommendations with respect to any legislative or regulatory changes which I think may be advisable in relation to matters which have formed part of this Inquiry. The recommendations for legislative or regulatory changes which follow are the product of my own deliberations. I did not specifically invite submissions to the Commission on this subject; however, I did receive a number of both written and verbal submissions which dealt with this subject. Neither members of the public nor the financial institutions which may be affected by these recommendations, nor the regulatory agencies who may have to administer the legislation have had an opportunity to comment upon the recommendations. Consequently, these recommendations should be taken more as proposals for reform which should be considered by the Minister in consultation with others whom the Minister may wish to consult.

I made a brief analysis of the Investment Contract Act in Part 14 of this Report. I think that one of the problems with the current legislation is that many members of the public have misperceived the role and function of this legislation and the role and function of the Superintendent of Brokers under this legislation. Some members of the public have gained the impression that registration of a company under this legislation meant that the Superintendent of Brokers was, in effect, warranting the security of any investments placed with these companies. To some extent this impression was fostered by the language used in some of the Principal brochures and by representations made by some of the Principal consultants. In fact, registration of an investment company under this Act or the renewal of registration does not invoke any warranty or guarantee by the Superintendent or other regulatory body. It merely means that the Superintendent has been satisfied that the investment contract company has complied with the filing requirements of the Act and that there is no evidence before the Superintendent that the investment contracts offered by the company would tend to be a fraud on the buyers of the contracts.

The initial recommendations for legislative of regulatory change are those upon which a high priority should be placed. The subsequent recommendations which involve a greater degree of regulation of the investment contract industry. Some of the concluding recommendations involve seeking the cooperation of federal agencies. The term "legislative amendment" or similar term in the following paragraphs includes amendments to regulations if that approach is necessary of desirable.

(a) Access of Investors to Financial Information

In order to be able to make better informed investment decisions, prospective purchasers of investment contracts need to have greater access to information concerning the financial affairs of an investment contract company. A prospective investor should be entitled to receive from the company a copy of the company's most recent audited financial statement. At the present time there is no requirement in the Investment Contract Act that an investment contract company provide investors or potential investors with audited financial statements of other financial information about the company. Furthermore, having made an investment, an investor has a continuing interest in this type of financial information and should be entitled to receive annual audited financial statement in order that the investor will be in a better position to monitor the performance of the company and thereby make a well informed investment decisions when the contract matures.

RECOMMENDATION EIGHT:

(A) Consideration should be given to making legislative amendments which will require an investment contract company to provide a copy of its most recent audited financial statements to an investor or prospective investor upon the request of such an investor;

(B) Consideration should be given to making legislative amendments which will provide that any person may, upon payment of a reasonable charge, obtain copies of the audited financial statements of an investment contract company from the regulatory agency where such statements are required to be filed;

(C) Consideration should be given to making amendments to the Securities Act or regulations made thereunder which would make the immediately preceding recommendations lettered (A) and (B) apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

(b) Disclosure of Investment Portfolio

Prior to making their investment, purchasers of investment contracts should be entitled to disclosure of the company's investment portfolio with sufficient particularity to enable the investors to make an informed investment decision. They should also be advised of any material change in the overall make-up of the investment portfolio. At the present time, the Investment Contract Act does not require investment contract companies to provide this information to investors or prospective investors. In the context of FIC/AIC, many of the persons who hold investment contracts in these companies would not have invested their money with these companies if they had received specific information about the nature of the investment portfolio held by these two companies.

RECOMMENDATION NINE:

(A) Consideration should be given to making legislative amendments which will require an investment contract company to provide prospective investors with sufficient particulars of the company's investment portfolio to enable a prospective investor to ascertain the specific nature of the investments held by the company and the approximate proportion of the total investment portfolio that each class of investments represents;

(B) Consideration should be given to making legislative amendments which will require an investment contact company to immediately advise investors of any material change in the nature of its investment portfolio;

(C) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A) and (B) apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

(c) Use of the Term "Guarantee"

A great many of the investors in FIC/AIC were told that their investment was "guaranteed" in some manner. Many of the investors, and particularly those whose first language was not english, did not understand the the use of the word "guarantee" in the brochures distributed by the Principal Group of companies and in the sales presentations by the Principal consultants. Furthermore, many did not understand or appreciate the distinction between "guaranteed" and "insured by the Canada Deposit Insurance Corporation". Some investors thought that "guaranteed" meant "insured by the Canada Deposit Insurance Corporation". Unfortunately the term "guarantee" is commonly used in at least two different contexts and the term has a different meaning depending on the context in which it is used. One of the common usages of the word "guarantee" is by manufacturers and retailers of certain products who often advertise that they guarantee their merchandise. When the term "guarantee" is used in that's context, it merely means that the manufacturer or vendor stands behind its product and will replace a defective product or refund the purchase money to a dissatisfied purchaser. This type of "guarantee" would be more accurately referred to in law as a "warranty". If the manufacturer or retailer who offers this type of guarantee goes bankrupt or goes out of business, there is no other person or company who will stand behind this type of "guarantee" or "warranty" and refund the purchaser's money if the product is defective.

Another common use of the term "guarantee" is in relation to loans, promissory notes and mortgages. In this context, if "A" wishes to borrow money from lender called "B", the lender may insist that "C" guarantee repayment of the loan which "B" is making to "A". If "A" goes bankrupt or otherwise defaults on the repayment of the loan, the lender may enforce repayment of the loan from "C". Here, there is another person to whom the lender can look for payment.

The term "guaranteed" is frequently used by chartered banks, trust companies, credit unions and other financial institutions to describe some forms of investments offered by these institutions. The terms "Guaranteed Investment Recent" or its short hand abbreviation "G.I.R." and "Guaranteed Investment Certificate" have become part of the standard terminology used by both customers and financial institutions. These types of "guaranteed" investments are purchased by large segments of the population as a means of holding their savings and as a means of providing an income for themselves after their retirement. These people do not regard these "guaranteed investments" as investments bearing any investment risk in the manner of an investment in the stock market because these investments are "guaranteed". Many but not all of these "guaranteed" investments are insured by the Canada Deposit Insurance Corporation. Most of the "guaranteed investment receipts" or "guaranteed investment certificates" which are not insured by CDIC do not have any other independent person or agency which is legally compellable to pay the amount of the receipt or certificate if the financial institution fails. It is this lack of uniformity in the security behind the use of the word "guarantee" which needs to be addressed by some form of legislative action.

RECOMMENDATION TEN:

(A) Consideration should be given to making legislative amendments which would limit use of the term "guarantee" in relation to the sale of investment contracts, investment certificates, and investment receipts, to circumstances:

(i) Where the investment is insured by the Canada Deposit Insurance Corporation;

(ii) Where the investment is guaranteed or insured by the Credit Union Deposit Insurance Corporation of British Columbia;

(iii) Where the investment is guaranteed by another legal entity which operates at arms-length from the company offering the guaranteed investment, and the identity of the guarantor is clearly identified to the purchaser ;

(iv) Where the investment is guaranteed by another legal entity approved by the British Columbia Securities Commission or similar regulatory agency.

(B) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A) (ii) to (iv) inclusive, apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

(d) Design and Content of the Application Form

The most important document in investment transactions of the nature which are the subject of this Report is the application form which is signed by the investor. If the design and content of these forms is not properly controlled, they have a substantial potential to mislead and deceive investors. These forms should include certain information and be designed in a manner that information about such matters as a lack of CDIC coverage will most likely come to the attention of the investor before he or she signs the application form. Furthermore these forms should not include certain types of information which may tend to mislead an investor.

During the past ten years, FIC/AIC have used at least three forms of applications forms for the purchase of investment contracts. In all the forms which have come to my attention, there has been a statement that the investment is not covered by Canada Deposit Insurance Corporation but the prominence with which that statement has been expressed has varied considerably. Furthermore some of the forms contained a tear off signature card which was used with respect to a Principal Savings and Trust Company chequing account with the latter company's name in large bold black print which was in much closer proximity to the investor's signature than the names of FIC/AIC.

RECOMMENDATION ELEVEN:

(A) Consideration should be given to making legislative amendments which will require that any application form, which an investment contract company proposes to use, be approved by the Superintendent of Brokers or other regulatory official before it used by an investment contract company;

(B) Consideration should be given to requiring the identity of the investment contract company which is offering the investment contract be clearly identified in bold lettering on the face of the application form;

(C) Consideration should be given to requiring that the absence of CDIC insurance coverage be displayed in bold print immediately above the space provided for the signature of the applicant.

(D) Consideration should be given to making amendments to the regulations under the Securities Act which would make the immediately preceding recommendations lettered (A) to (C) inclusive apply, with any necessary changes, to the purchase of promissory notes which are sold under the provisions of section 32 of the Securities Act.

(e) Regulation of Investment Contract Companies

The Investment Contract Act is legislation which has not been substantially revised or modernized since it was first enacted in 1962. With the demise of FIC/AIC, only one investment contract company remains registered pursuant to provisions of this Act. The Investment Contract Act does not contain the types of controls and remedies which are necessary to regulate the activities of companies such as FIC and AIC. The Province has recently enacted a new Securities Act which provides a modern and sophisticated approach to the regulation of financial institutions. Many of the provisions which are included in the Securities Act would suitable for adoption and application to investment contract companies. Some advantages which would accrue to the purchasers of investment contracts if the Securities Act was made to apply to investment contract companies would include:

The right of a purchaser to receive a copy of the company's prospectus (Section 66);

The right to a purchaser, where the sale contract was entered into before purchaser received the prospectus, to rescind the contract if the purchaser notifies the vendor within two days of receiving the prospectus (Section 66);

The right of a purchaser, who did not receive a prospectus, to bring an action for damages or rescission of the contract (Section 118);

The right of a purchaser, where a prospectus contains a misrepresentation, to bring an action for damages against every person who was a director of the issuer at the time when the prospectus was issued (Section 114).

The Securities Act provides the type of regulation and remedies which are suitable and appropriate for investment contract companies in today's investment market. If this recommendation is acted upon and investment contract companies are required to issue a prospectus which includes information about the financial statements of the company and the investment portfolio of the company, many aspects of the previous recommendations for legislative or regulatory reform will be covered by the application of the Securities Act to investment contract companies.

RECOMMENDATION TWELVE:

> Consideration should be given to repealing the Investment Contract Act and making such amendments to the Securities Act as may be necessary to bring investment contract companies under the jurisdiction of those parts of the Securities Act that would be applicable to investment contract companies. If this recommendation is accepted, it may be necessary to consider enacting transition provisions which will apply to the one remaining company which is currently registered under the Investment Contract Act and thereby enable that company sufficient time to comply with the provisions of the Securities Act.

(f) Use of Reference to CDIC Membership

The unqualified statement by a financial institution that it is a member of the Canada Deposit Insurance Corporation has a tendency to mislead members of the public because not all of the investments which are sold by a financial institution are covered by CDIC insurance. CDIC has had a policy since March 11, 1986 which provides that CDIC does not permit its members to refer to membership in CDIC on letterhead, stationery and application forms. This policy also provides that the following statement must appear on all documentation relative to uninsured investments:

> "THIS IS NOT A DEPOSIT INSURED UNDER THE CANADA DEPOSIT INSURANCE CORPORATION ACT"

A copy of this policy is included in Appendix 17.2 of this Report. Unfortunately, this policy does not go far enough in controlling abuses which may arise from the general reference to CDIC membership when a financial institution is also selling investments which are not covered by CDIC insurance. The following recommendation, if it is implemented, would provide average citizens with more reliable information about whether a particular investment is insured by CDIC.

RECOMMENDATION THIRTEEN:

(A) Consideration should be given to entering into discussions with the Canada Deposit Insurance Corporation with the object of limiting the use, by member institutions, of references to "Canada Deposit Insurance Corporation" to only those deposits, term deposits, term certificates, investment receipts and other investments which are covered by CDIC insurance, rather than permitting the use of a general reference to CDIC membership by a financial institution which sells investments which are not covered by CDIC insurance.

(B) If the objective described in the preceding paragraph cannot be achieved, then, as an alternative, consideration should be given to requiring financial institutions which operate in British Columbia and which sell some investments which are covered by CDIC insurance and some which are not covered by CDIC insurance, to state, in any advertising published in British Columbia that includes a reference to CDIC, that not all of the investments sold by the financial institution are covered by CDIC insurance.

(g) Investment of Holdings in British Columbia

Another means of exercising a greater degree of control over investment contract companies which want to operate in British Columbia, is to require that these companies maintain a proportion of their investments which is approximately equal to the proportion of investment contracts sold in British Columbia. These investments could be either in property which is located in British Columbia, or securities which are in the custody of a custodian who is present in British Columbia and who is approved by the appropriate regulatory agency. In the latter case, the securities could relate to investments outside British Columbia. The implementation of this type of proposal could have two benefits. Firstly, it would put regulators in British Columbia in a better position to monitor the value of the investment portfolio of an investment contract company, and there would be assets in British Columbia which could be seized and used to satisfy the claims of creditors if the company should fail. Secondly, the adoption of this proposal might have the effect of encouraging investment in British Columbia.

RECOMMENDATION FOURTEEN:

> Consideration be given to a proposal which would require a proportion of the investments of an investment contract company which is approximately equal to the proportion of investment contracts sold in British Columbia, to be invested in either property which is located in British Columbia, or securities which are held by a custodian which is present in British Columbia and approved by the appropriate regulatory agency.

17.3: EVIDENCE - Custody of and Access to Evidence Gathered During the Inquiry

This part of the Report makes recommendations with respect to who should have custody of the evidence gathered during the course of the Inquiry, and who should have access to this evidence.

RECOMMENDATION FIFTEEN:

> Subject to the stipulations enumerated in Recommendations 16 to 21, the evidence gathered by the Commission during the course of the Inquiry should be delivered into the custody of the Director of Trade Practices appointed pursuant to the Trade Practice Act.

RECOMMENDATION SIXTEEN:

> The Director or Trade Practices and his legal counsel may use the evidence in the continuation of the legal proceedings which the Director has already commenced or for such other proceedings as the Director may commence.

RECOMMENDATION SEVENTEEN:

> The Attorney-General of British Columbia, or agents authorized by him, should have access to the evidence gathered by the Commission and should have the right to make such copies of the evidence as he may require.

RECOMMENDATION EIGHTEEN:

> The Special Counsel, who is referred to in Part 15.6 of this Report, and who has been appointed by the Alberta Court of Queen's Bench to represent British Columbia investors, should have access to the evidence gathered by the Commission and he should have the opportunity to make such copies of the evidence as he may require.

RECOMMENDATION NINETEEN:

The Inspector, who is referred to in Part 15.6 of this Report and who has been appointed pursuant to the Order of the Alberta Court of Queen's Bench to inquire into the Principal Group of Companies, should have access to the evidence gathered by the Commission and he should have the opportunity to make such copies of the evidence as he may require.

RECOMMENDATION TWENTY:

Persons, who may be authorized by the Minister of Labour and Consumer Services, or the Director of Trade Practices, should have access to the evidence gathered by the Commission and should have the opportunity to make such copies of the evidence as they may require. In this regard, I recommend that authorization, pursuant to this paragraph, be granted to a member of any class of investors referred to in this Report or legal counsel who has been retained by the investor.

RECOMMENDATION TWENTY-ONE:

There are three categories of evidence which were obtained as part of the Commission of Inquiry which should not be made accessible as recommended above.

(A) Evidence that pertains to the Confidential circumstances of certain Investors.

This evidence was provided to the Commission of Inquiry in confidence. It will not assist in the advancement of claims of other investors. There is no public interest to be served by making this evidence accessible to others. This evidence will be delivered, under separate cover, to the Minister.

(B) A single binder of Financial Information pertaining to FIC/AIC obtained on a Confidential Basis.

It is anticipated that this information will be made public as part of the Inquiry in Alberta being conducted by Mr. William Code, Q.C. This evidence will be delivered under separate cover to the Minister.

(C) One item of evidence which is still the subject of Investigation.

There is one item of evidence which is still under investigation. This evidence should be made accessible, as recommended above, as soon as the investigation of the evidence has been completed. This evidence will be delivered to the Director of Trade Practices for use in any proceedings commenced by him, and a copy of the evidence should be made immediately available to the Special Counsel referred to in Part 15 of this Report.

18.0: CONCLUSION

I wish to record my appreciation to Cindy Pyatt who served as Secretary to the Commission of Inquiry. Her assistance in making the arrangements for the Public Hearings, gathering evidence, responding to inquiries and preparing this report was invaluable.

I also wish to thank all of the people who contributed information, documents and other forms of evidence to the Commission. In particular, I wish to thank those persons who have money invested in any of the Principal Group of companies who took the time to make written submissions, complete and return questionnaires, provide copies of documents or attend one of the Public Hearings. I would be remiss if I did not also acknowledge the valuable information provided by several former Principal consultants and employees who were very forthcoming, and whose information and evidence has been very helpful.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

DATED at Victoria, Province of British Columbia, this 14th day of October, 1987.

Lyman R. Robinson

Lyman R. Robinson, Q.C.